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No. 11405

15. 2452
United States

Circuit Court of Appeals

For the Ninth Circuit.

PAUL A. PORTER, Administrator of the Office
of Price Administration,

Appellant,

vs.

PAUL MYERS,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the District of Arizona

FILED

OCT 26 1946

PAUL P. O'BRIEN,
CLERK

No. 11405

United States
Circuit Court of Appeals
For the Ninth Circuit.

PAUL A. PORTER, Administrator of the Office
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Answer to Complaint for Treble Damages	7
Appeal:	
Designation of Record and Proceedings to be Contained in Record on	31
Notice of	30
Order Extending Time for Filing and Doc- keting Record on	32
Statement of Points on	32
Attorneys of Record	1
Complaint for Treble Damages	2
Court's Memorandum	23
Designation of Record and Proceedings to be Contained in Record on Appeal	31
Findings of Fact, Conclusions of Law and Judgment	26
Memorandum of Points in Support of First Defense	9
Notice of Appeal	30
Order Extending Time for Filing and Docket- ing Record on Appeal	32
Order of Approval	18

Order Substituting Administrator's Successor as Party to Action	29
Statement of Points on Appeal	32
Stipulation for Judgment	10
Statement of Points on Appeal and Designa- tion of Record	36

ATTORNEYS OF RECORD

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District Enforcement Attorney,

Office of Price Administration,

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Phoenix, Arizona

Attorney for Appellant.

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Valley National Building,

Tucson, Arizona

Attorneys for Appellee. [3*]

* Page numbering appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States
for the District of Arizona

Civ. No. 273—Tucson

CHESTER BOWLES, Administrator,
Office of Price Administration,

Plaintiff,

vs.

PAUL MYERS,

Defendant.

COMPLAINT FOR TREBLE DAMAGES

Under the Emergency Price Control Act of 1942
(P. L. 421, 77th Congress, 2nd Session, 56 Stat.
23), as amended, for violations of Maximum
Price Regulation No. 259.

Plaintiff complains and alleges as follows:

1. Plaintiff, as Administrator, Office of Price Administration, brings this action for treble damages on behalf of the United States pursuant to the provisions of Section 205(e) of the Emergency Price Control Act of 1942 (P. L. 421, 77th Cong. 2nd Session, 56 Stat. 23), as amended by the Stabilization Extension Act of 1944, hereinafter called the "Act".

2. Jurisdiction of this action is conferred upon this court by Sections 205(e) and 205(c) of the Act.

3. That under and by virtue of the authority vested in the Price Administrator by the Act and Executive Order No. 9250, the Administrator of

the Office of Price Administration duly promulgated and issued Maximum Price Regulation No. 259 (7 F. R. 8950) to become effective November 1, 1942, establishing maximum prices for the sale by all sellers of domestic malt beverages within the continental limits of the United States; that said Maximum Price Regulation No. 259, issued as aforesaid, as the same has been amended, is now and at all times herein mentioned has been in full force and effect. [4]

4. That the said defendant, Paul Myers, is a resident of the City of Tucson, County of Pima, State of Arizona, and at all times herein mentioned, at the aforesaid place, has been and now is engaged in the business of buying, selling, distributing and otherwise dealing in "domestic malt beverages" in the capacity of a "wholesaler" as said terms are defined by the said Maximum Price Regulation No. 259.

5. That between December 1, 1943, and August 26, 1944, in the County of Pima, State of Arizona, and within the jurisdiction of this court, the said defendant offered for sale and sold to numerous purchasers at wholesale large quantities of domestic malt beverages, to-wit: beer, at prices in excess of the legal maximum prices provided by said Maximum Price Regulation No. 259; that attached hereto as "Exhibit A" and by reference incorporated herein is a tabulation by calendar months covering the aforesaid period showing the brands, container sizes and quantities of beer sold

by the said defendant as aforesaid, the sale price, the ceiling price, the amount of overcharge per case, and the total amount of overcharges demanded and received by the said defendant in the sale of said beer.

6. That the aforesaid sales, and each of them, were made at wholesale in the course of trade or business and not to ultimate consumers; that the amount by which the price demanded and received by the said defendant for said beer exceeded the maximum price therefor, as established by the applicable provisions of said Maximum Price Regulation No. 259, was the sum of twenty-eight thousand six hundred ninety-one and $74/100$ dollars (\$28,691.74), as more fully appears from Exhibit A attached hereto; that treble the aggregate amount of said overcharges demanded and received by said defendant, as aforesaid, is the sum [5] of eighty-six thousand seventy-five and $22/100$ dollars (\$86,075.22).

Wherefore, plaintiff prays judgment against the said defendant that plaintiff have and recover of and from the said defendant, Paul Myers, on behalf of the United States of America, the sum of eighty-six thousand seventy-five and $22/100$ dollars (\$86,075.22), and for such other and further relief as to the court may appear just and lawful in the premises.

Dated at Phoenix, Arizona, this 17th day of
November, 1944.

/s/ DARRELL R. PARKER,
District Enforcement Attor-
ney.

/s/ LLOYD J. ANDREWS,
Assistant Enforcement Attor-
ney.

/s/ DAVID O. BROWN,
Assistant Enforcement At-
torney.
Attorneys for Plaintiff
Office of Price Administration
17 West Van Buren Street
Phoenix, Arizona.

[Endorsed]: Filed Nov. 18, 1945. [6]

1944		June		Extra Charges—Delivery and Storage		—	3,527	74.00	3,060.61
		Heinies 12 oz.	1-4	3.95	3.17	.78	17	13.26	
			5-9	3.95	3.12	.83	29	24.07	
			10-24	3.95	3.07	.88	565	497.20	
			25 or over	3.95	2.97	.98	1,775	1,739.50	2,274.03
		Premium Premo 12 oz.	5-9	3.95	3.70	.25	4	1.00	
		25 or over	3.95	3.55		.40	1,500	600.00	601.00
		Extra Charges—Delivery and Storage							
							3,890	72.50	2,947.53

EXHIBIT A

DETAILED SUMMARY OF OVERCHARGES ON WHOLESALE BEER SALES

FROM DECEMBER 1, 1943 TO AUGUST 31, 1944

Period Involved	Brackets Beer Involved, before addition for Arizona State Liquor Tax	Case Lost	Per Case		Detail	Number of Cases		Detail	Amount of Overcharge	
			Sales Price	Colling Over-		Brand	Monthly Totals		Brand	Monthly Totals
1943	December	ABC Supreme 12 oz.	25 or over 2.96	2.76	.20	100		20.00		
			25 or over 2.86	2.76	.10	1,335		133.50		153.50
		Heinies 12 oz.— Clifton	25 or over 3.33	3.08	.25	1,435		358.75		358.75
		Extra Charges—Delivery and Storage				—	2,570		138.00	650.25
1944	January	ABC Supreme 12 oz.	25 or over 2.96	2.76	.20	100		20.00		
			25 or over 2.88	2.76	.12	2,025		243.00		
			25 or over 2.86	2.76	.10	2,870	4,995	287.00		550.00
		Heinies 12 oz.	25 or over 3.43	2.90	.53	1,490	1,490	789.70		789.70
		Extra Charges—Delivery and Storage				—	6,485		208.50	1,549.20
February		ABC Supreme 12 oz.	25 or over 2.86	2.76	.10	676	676	67.60		67.60
		ABC Supreme 32 oz.	25 or over 3.20	3.09	.11	180	180	19.80		19.80
		Heinies 12 oz.	25 or over 3.43	2.90	.53	1,400	1,400	742.00		742.00
		Extra Charges—Delivery and Storage				—	2,256		160.00	989.40
March		ABC Supreme 12 oz.	25 or over 2.86	2.76	.10	2,054	2,054	205.40		205.40
		Heinies 12 oz.	5-9	3.88	3.05	.83	10	8.30		
			10-24	3.88	3.00	.88	30	26.40		
			25 or over 3.88	2.90	.98	3,440	3,440	3,332.00		3,366.70
		Yankee 32 oz.	25 or over 4.65	3.63	1.02	1,400	1,400	1,428.00		1,428.00
		Extra Charges—Delivery and Storage				—	6,894		184.50	5,184.60
April		ABC Supreme 12 oz.	25 or over 2.93	2.83	.10	450	450	45.00		45.00
		ABC Supreme 32 oz.	25 or over 3.29	3.18	.11	155	155	17.05		17.05
			25 or over 3.26	3.18	.08	30	185	2.40		19.45
		Heinies 12 oz.	10-24	4.07	3.07	1.00	5	5.00		
			5-9	4.00	3.12	.88	5	4.40		
			10-24	3.95	3.07	.88	30	26.40		
			25 or over 3.95	2.97	.98	2,160	2,160	2,116.80		
			25 or over 3.88	2.97	.91	50	2,250	45.50		2,198.10
		Yankee 32 oz.	25 or over 4.74	3.72	1.02	600	600	612.00		612.00
		Extra Charges—Delivery and Storage				—	3,485		87.50	2,962.05
May		ABC Supreme 12 oz.	25 or over 2.93	2.83	.10	475	475	47.50		47.50
		Heinies 12 oz.	1-4	3.95	3.17	.78	7	5.46		
			5-9	3.95	3.12	.83	25	20.75		
			10-24	3.95	3.07	.88	860	756.80		
			25 or over 3.95	2.97	.98	1,090	1,982	1,068.20		1,851.21
		Yankee 32 oz.	10-24	4.74	3.82	.92	35	32.20		
			25 or over 2.74	3.72	1.02	1,070	1,070	1,055.70		1,087.90
		Extra Charges—Delivery and Storage				—	3,327		74.00	3,060.61
1944	June	Heinies 12 oz.	1-4	3.95	3.17	.78	17	13.26		
			5-9	3.95	3.12	.83	29	24.07		
			10-24	3.95	3.07	.88	565	497.20		
			25 or over 3.95	2.97	.98	1,775	2,386	1,739.50		2,274.03
		Premium Premo 12 oz. 25 or over 3.95 3.55	5-9	3.95	3.70	.25	4	1.00		
		Extra Charges—Delivery and Storage				—	3,890		600.00	2,947.53
July		ABC Supreme 12 oz.	25 or over 2.93	2.83	.10	930	930	93.00		93.00
		Heinies 12 oz.	1-4	3.95	3.17	.78	1	.78		
			5-9	3.95	3.12	.83	25*	20.75		
			10-24	3.95	3.07	.88	1,765*	1,553.20		
			25 or over 3.95	2.97	.98	2,280	4,071	2,234.40		3,809.13
		Yankee 32 oz.	10-24	4.74	3.82	.92	10	9.20		
			25 or over 3.95	2.97	1.02	1,450	1,460	1,479.00		1,488.20
		Capitol 12 oz.	5-9	3.65	3.13	.52	5	2.60		
			10-24	3.65	3.08	.57	235	133.95		
			25 or over 3.65	2.98	.67	2,746	2,986	1,839.82		1,976.37
		Extra Charges—Delivery and Storage				—	9,447		178.10	7,544.80
August**		ABC Supreme 12 oz.	25 or over 2.93	2.83	.10	1,600	1,600	160.00		160.00
		Heinies 12 oz.	10-24	3.95	3.07	.88	50	44.00		
			25 or over 3.95	2.97	.98	110	160	107.80		151.80
		Yankee 32 oz.	10-24	2.74	3.82	.92	10	9.20		9.20
		Capitol 12 oz.	10-24	3.65	3.08	.57	410	233.70		
			25 or over 3.65	2.98	.67	1,385	1,795	927.95		1,161.65
		Capitol 32 oz.	10-24	4.16	3.53	.63	240	151.20		
			25 or over 4.16	3.43	.73	2,739	1,999.47	2.00		
			1-4	4.13	3.63	.50	1	.60		
			10-24	4.07	3.53	.54	12	6.18		2,159.15
		Extra Charges—Delivery and Storage				—	6,560		161.50	3,803.30
		TOTALS					45,414			\$28,691.74

* Includes 150 cases of Heinies Beer billed on July 31, 1944. Invoices which were not entered on the books until August 1, 1944.
 ** Month of August checked only until the 28th. Invoices billed after this date were to be computed at selling rate.

[Title of District Court and Cause.]

ANSWER TO COMPLAINT
FOR TREBLE DAMAGES

First Defense

The complaint fails to state a claim against the defendant upon which relief can be granted.

Second Defense

Defendant, for his answer to plaintiff's complaint, admits, denies and alleges as follows:

I.

Admits the allegations contained in Paragraphs 1, 2 and 4 of said complaint, but in answer to paragraph 3 of said complaint, defendant denies that the Maximum Price Regulation No. 259 has the force and effect of law.

II.

Admits that "between December 1, 1943, and August 26, 1944, in the County of Pima, State of Arizona, and within the jurisdiction of this court, the said defendant offered for sale and sold to numerous purchasers at wholesale large quantities of domestic malt beverage, to-wit: beer" but denies that any of said beer so offered for sale and sold by the defendant to such purchasers was offered for sale or was sold at prices in excess of the maximum price therefor as established by the applicable provisions of Maximum Price Regulation No. 259, referred to in plaintiff's complaint, or by the General

Maximum Price Regulation theretofore promulgated and issued by said [10] Administrator, but, on the contrary, alleges that all of the sales mentioned and described in Exhibit "A" to plaintiff's complaint were made at or below maximum prices provided by Maximum Price Regulation No. 259 and said General Maximum Price Regulations.

III.

In answer to the allegations contained in Paragraph 6 of said complaint, defendant admits that said sales and each of them were made at wholesale in the course of trade or business and not to the ultimate consumer, but denies that the price demanded and received by defendant exceeded the maximum price therefor as established by the applicable provisions of said Maximum Price Regulation No. 259 and the applicable provisions of said General Maximum Price Regulation, in the aggregate sum of \$28,691.74, or in any other amount. Defendant admits the making of the sales mentioned, set forth and described in Exhibit "A", but denies specifically each and every other allegation contained in said complaint and in said Exhibit "A".

IV.

Defendant further alleges that all of the sales made by defendant and referred to in plaintiff's complaint were made at prices which were computed in accordance with the business and cost practices or methods established in the brewery and distillery products industry prior to the enactment

of said Emergency Price Control Act referred to in plaintiff's complaint.

V.

Defendant, as a further and separate answer to said complaint, alleges: That if it should be established that any of the sales mentioned, set forth and described in plaintiff's complaint* were made in violation of said Maximum Price Regulation No. 259, that such violation of such regulation by this defendant was neither willful nor the result of failure on defendant's part [11] to take practicable precautions against the occurrence of the violation.

Wherefore, defendant prays judgment dismissing the complaint, for his costs and for such other relief as the court may deem just.

KNAPP, BOYLE & THOMP-
SON

B. G. THOMPSON,
ARTHUR HENDERSON,
Attorneys for Defendant
910 Valley National
Building
Tucson, Arizona.

MEMORANDUM OF POINTS IN
SUPPORT OF FIRST DEFENSE

The Court takes judicial notice of all of the matters appearing in the Federal Register. It appears from said Federal Register that no statement of

the considerations involved in the issuance of Maximum Price Regulation No. 259 was published in said Federal Register, as provided by Title 50, USCA, Sections 902, 921. It appears from said Federal Register that while Maximum Price Regulation No. 259 was published, no statement of the considerations involved in the issuance of said regulation was likewise published but said statement was merely filed with the Division of Federal Register. Until and unless such statement of the considerations involved in the issuance of Maximum Price Regulation No. 259 are likewise published in the Federal Register, the said Maximum Price Regulation No. 259 could not have the force of law, nor can it be made the basis of any cause of action against this defendant as set forth in the complaint herein.

[Endorsed]: Filed Jan. 10, 1945. [12]

[Title of District Court and Cause.]

STIPULATION FOR JUDGMENT

Come now the attorneys undersigned for the above-named plaintiff and defendant respectively and stipulate and agree as follows:

1. That jurisdiction of this action is conferred upon this court by Section 205(c) and (e) of the Emergency Price Control Act of 1942, as amended.

2. That pursuant to the Act the Price Administrator has heretofore duly promulgated and issued

Maximum Price Regulation No. 259, which became effective on November 1, 1942, and, as amended, has been in full force and effect at all times thereafter until the revision thereof which became effective December 18, 1944; that said Maximum Price Regulation No. 259 establishes maximum prices for the sale at wholesale of domestic malt beverages within the continental limits of the United States.

3. That Paul Myers, the defendant herein, is and at all times pertinent hereto has been a resident of the City of Tucson, County of Pima, State of Arizona, and engaged in the business of buying, selling, and distributing at wholesale and in the capacity of a "wholesaler" of "domestic malt beverages" as said terms are defined by said Maximum Price Regulation No. 259.

4. That during the period December 1, 1943, to August 26, 1944, in the said County of Pima, State of Arizona, the plaintiff contends that the defendant, Paul Myers, offered for sale and [14] sold to numerous purchasers quantities of domestic malt beverages, to-wit: beer, at prices in excess of the legal maximum prices provided by said Maximum Price Regulation No. 259.

5. That it is agreed between these parties that maximum prices at which the said defendant, Paul Myers, might lawfully offer for sale or sell domestic malt beverages during the period above mentioned are established and determined by Section 1420.66, Appendix A(a) of the said Maximum Price Regulation No. 259.

6. It is further stipulated and agreed that the month of March, 1942, be considered the "base period" for the purpose of determining said maximum prices and that the proper method of computing the maximum prices on brands of beer not sold or offered for sale by the defendant during said month of March, 1942, but offered for sale and sold by him for the first time subsequent to the said month of March, 1942, shall be as provided by Section 3(a) (Section 1499.3(a)) of the General Maximum Price Regulation (7 F. R. 3153).

7. It is also stipulated by and between these parties that during the said month of March, 1942, the said defendant was engaged exclusively in the sale at wholesale of ABC beer and ale, products of Aztec Brewing Company, Inc. of San Diego, California, and that for the purpose of determining the proper maximum price of brands of beer other than ABC beer and ale the products of said Aztec Brewing Company, Inc. of San Diego, California, actually handled by said defendant during the month of March, 1942, shall be considered the "comparable commodity" referred to hereinabove.

8. In order to effect a settlement of this action it is hereby stipulated and agreed between these parties that, subject to the matters hereinafter reserved for future determination of this court, the actual overcharges demanded and received by the said defendant during the period alleged in plaintiff's complaint on file herein in connection with the sale of commodities described [15] in said com-

plaint and attached Exhibit "A" are the sum of \$27,426.14 and that, subject to and contingent upon determination of this court of the matters and legal questions hereinafter reserved for future decision favorable to the plaintiff, judgment be entered herein in favor of the plaintiff and against the defendant in the sum of \$27,426.14, which said judgment shall bear interest and be payable as hereinafter provided.

9. These parties further stipulate that in computing the overcharges during the period mentioned in plaintiff's complaint the plaintiff has made no allowance for return freight to the brewery on empty cases and bottles or brokerage commissions or finder's fees paid by said defendant in connection with the purchase and sale and handling of any of the commodities referred to in plaintiff's complaint, and that it is the contention of the plaintiff that said items do not properly constitute elements in defendant's net cost of the commodities described in plaintiff's said complaint under the provisions of the said Section 3(a) (1499.3(a)) of the General Maximum Price Regulation for the reason, among others, that no such return freight or commissions as such were paid during the month of March, 1942, by the said defendant in connection with the "comparable commodity" being handled and sold by defendant during the said month.

It is stipulated that during the said month of March, 1942, the cost of return freight on empty bottles and cases was absorbed by Aztec Brewing

Company, Inc. of San Diego, California, and not charged to said defendant nor paid by him, as such, and further that during the said month of March, 1942, the defendant paid no brokerage commissions or finder's fees in connection with the purchase of any malt beverage handled by him during said month.

That in response to request of defendant the letters hereto attached as Exhibits "A" and "B" were written to defendant [16] by the Phoenix District Office, Office of Price Administration.

10. That it is the contention of the defendant that in calculating maximum prices for commodities or brands thereof not handled or sold by him during March, 1942, but only during the period subsequent to said month, and in particular during the period mentioned in plaintiff's complaint, under the provisions of the regulation of the Office of Price Administration hereinabove mentioned and referred to more specifically, the said defendant is entitled to include as a proper part and element of his net unit cost of the said commodities, sums charged to him by his suppliers and actually paid by him in the form of commissions, brokerage charges, or finder's fees, and return freight to brewery on empty cases and bottles, and the determination of the controversy described in this, and the paragraph next preceding this paragraph, is hereby expressly reserved for this court, and in the event the said court should determine that any of the above mentioned charges properly constitute a part of or

element in defendant's net unit cost referred to and defined by the General Maximum Price Regulation hereinabove mentioned, then and in that event, the amount of the judgment to be entered herein in favor of the plaintiff and against the defendant shall be accordingly reduced.

11. That is is stipulated between these parties that in the event the court should find that return freight is a proper and legitimate element of net unit cost for the purpose of computing maximum prices of the commodities mentioned in plaintiff's complaint during the period therein set forth, the actual amount of the overcharges are to be reduced by the sum of \$4,223.30; that in the event the court should find that both return freight and commissions, brokerage charges, and finder's fees paid by said defendant in connection with the purchase of the aforesaid commodities constitute proper elements of net unit cost, the said actual overcharges on account thereof shall be reduced by the total sum [17] of \$9,086.14, and likewise the judgment to be entered herein in favor of the plaintiff against the defendant shall accordingly be reduced.

12. That further clarifying the preceding paragraph numbered 11., it is the intention and agreement of these parties that in the event this court should determine that return freight on empties should be allowed as an element of net unit cost, the judgment to be entered herein in favor of the plaintiff and against the defendant shall be the sum of \$23,202.84; that in the event the court should

determine that both the return freight and the brokerage commissions constitute proper elements of net unit cost of the commodities in question, the judgment to be entered herein in favor of the plaintiff and against the defendant shall be the amount of \$18,329.20.

13. That upon the determination of the aforesaid issues by the court, judgment shall be entered for the plaintiff and against the defendant for the benefit of the United States of America in such amount, not to exceed \$27,426.14, as the court may determine in accordance with the provisions of this stipulation and the applicable statutes and regulations pertaining to the subject matter hereof.

14. That any judgment which shall be entered herein pursuant to this stipulation shall be payable in the following manner and at the following times, unless the said defendant shall desire to sooner pay the same, to-wit: One-third thereof payable upon the entry of judgment and in no event later than ten (10) days thereafter; one-third, together with accrued interest, to be payable on or before (6) months from date of said judgment, and the balance thereof, together with accrued interest, payable on or before one (1) year from the date of said judgment; that all deferred payments shall bear interest from date of judgment until fully paid at the rate of four (4) per cent per annum. [18]

That in the event the said defendant shall pay or cause to be paid on or before the dates hereinabove provided the amounts hereinabove provided, to-

gether with accrued interest, no process shall issue for the collection or enforcement of said judgment, or any action or proceeding whatever to enforce payment of the same shall be instituted or brought; that in the event of default in making of any of the payments hereinabove provided or any part thereof promptly on the dates hereinabove specified, the whole of said judgment shall forthwith, and without notice to said defendant, become immediately payable and payment thereof may be enforced by the plaintiff or any other proper agency or department of the Government of the United States by any and all means provided by law for the collection and enforcement of judgments.

15. That this stipulation shall not be deemed effective until approved by the Judge of the above entitled court.

16. That attorneys for the defendant shall within thirty (30) days of the date of the filing of this stipulation, if they so desire, file herein a brief in support of defendant's contentions respecting the questions of law hereinabove expressly reserved for determination of this court; that within twenty (20) days of the date of filing defendant's said brief the attorneys for plaintiff may file herein their answering brief, and that attorneys for defendant shall be allowed the period of ten (10) days thereafter for the submission and filing of a reply brief, if they so desire.

That attorneys for either party may request oral argument on said contentions, provided such re-

quest is filed not later than the date of filing such reply brief.

Dated this 27th day of April, 1945.

/s/ DARRELL R. PARKER,
District Enforcement Attorney. [19]

/s/ LLOYD J. ANDREWS,
Assistant Enforcement Attorney

/s/ DAVID O. BROWN, LJA
Assistant Enforcement Attorney
Attorneys for Plaintiff.

/s/ PAUL MYERS,
Defendant.

KNAPP, BOYLE THOMPSON
B. G. THOMPSON,
Attorneys for Defendant.

[Endorsed]: Filed May 7, 1945.

ORDER OF APPROVAL

The above and foregoing stipulation having been presented to the court, and the court having duly considered the same:

It Is Hereby Ordered that the said stipulation be and it is hereby approved, and it is directed that the same be filed in this cause.

Dated this Eighth day of May, 1945.

ALBERT M. SAMES,

Judge, United States District
Court.

[Endorsed]: Filed May 8, 1945. [20]

EXHIBIT "A"

Phoenix District Office
Office of Price Administration
17 W. Van Buren Street
Post Office Box 650
Phoenix, Arizona

September 14, 1945

Mr. Paul L. Myers
302 So. Park Avenue
P. O. Box 2832
Tucson, Arizona

Dear Mr. Myers:

Today, we received an answer from the Regional Office to our inquiry on including the cost of return of empty bottles in your net replacement cost. The Regional Office advises us that its conclusion is that return freight on empty bottles may be included in your net cost for the purpose of pricing your beer under Section 3(a) of General Maximum Price Regulations.

Your correct method of pricing Capitol Beer sold by you is, then, as follows:

1. The comparable commodity you are using is,

I believe, ABC Beer. Take your maximum price under OPA regulations for that beer.

2. Divide this price by the net unit replacement cost of ABC Beer.

3. Multiply the percentage so obtained by your net unit cost of Capitol Beer or the beer being priced. This unit replacement cost may include the cost of Capitol Beer at the brewery, the loading charge at the brewery, freight on full cases and freight on the return of the empty bottles to the brewery.

Under Section 3(a) of General Maximum Price Regulation, all customary allowances, discounts or other price differentials shall apply to the sale of the commodity being priced. Therefore, you must give the same quantity discounts on Capitol Beer that you have established for ABC Beer.

This letter may be considered an official interpretation, and if you have any further question regarding its application, you may communicate directly with this office, and if you question its application to your problem, request that we send the question to our Regional Office for consideration by them and for clarification of doubtful points.

Very truly yours,

RICHARD A. HARVILL,

District Price Executive.

By: /s/ BETTY C. FREDERICKSON

District Price Attorney. [21]

EXHIBIT "B"

Phoenix District Office
17 W. Van Buren Street
Post Office Box 650
Phoenix, Arizona

September 29, 1944

Mr. Paul L. Myers
302 So. Park Avenue
P. O. Box 2832
Tucson, Arizona

Dear Mr. Myers:

Since we wrote you concerning the pricing of Capitol Beer handled by you, on September 14th, the National Office of OPA has reversed the ruling of the Regional Office. The Washington ruling is that the cost of returning beer bottles to the supplier may not be considered part of the net cost of the commodity by pricing under Section 3(a) of General Maximum Price Regulation.

Thus, numbered paragraph 3 of our letter of September 14th should be modified to read:

"Multiply the percentage so obtained by your net unit cost of Capitol Beer or the beer being priced. This unit replacement cost may include the cost of Capitol Beer at the brewery, the loading charge at the brewery and freight on full cases."

This letter is to be considered an amendment to the interpretation given you in our letter of the 14th, so that the same privilege of questioning it is applicable and you may, if you wish, request

that the problem be considered by the regional office and if necessary, by the national office.

Under the circumstances, since this ruling came directly from the Washington office, I believe it is pretty final and that you must immediately recalculate your price on Capitol Beer.

Very truly yours,

RICHARD A. HARVILL,

District Price Executive.

By: /s/ BETTY C. FREDERICKSON

District Price Attorney.

cc: JAMES J. SILVER, Esq.,

84 W. Pennington,

Tucson

cc: OPA Tucson

cc: Enforcement Division [22]

[Title of District Court and Cause.]

Minute Entry of Tuesday, December 18, 1945
(Tucson Division)

Honorable Albert M. Sames, United States District Judge, Presiding.

It Is Ordered that the plaintiff, Chester Bowles, have judgment herein against the defendant, Paul Myers, in the sum of \$18,329.20, and that counsel for the plaintiff prepare and submit form therefor.

[Title of District Court and Cause.]

COURT'S MEMORANDUM

Defendant's proposed findings of fact and conclusions of law having been presented to the Court and no objections thereto having been urged by plaintiff, Is Is Ordered that the Clerk file said findings of fact and conclusions of law as approved and entered by the Court and that the form of judgment appended to said findings of fact and conclusions of law be approved, filed, entered and spread upon the minutes as the judgment in this case.

The Court has determined to enter judgment for the plaintiff in the sum of \$18,329.20, the smallest amount stipulated for by the parties, for the following reasons:

(1) Net unit cost includes any cost lawfully charged by a supplier and paid by a seller such as the defendant herein;

(2) The defendant's new supplier's maximum price as fixed by the Office of Price Administration included return freight on empty beer bottles and such new supplier properly charged return freight on empty beer bottles;

(3) The return freight on empty beer bottles as charged by the new supplier is an item to be included in the defendant's net unit cost;

(4) The defendant, though including return freight on empty beer bottles and though including finder's fees in fixing his maximum price on the new

commodity as items of net unit cost none-the-less continued his customary allowances, discounts, etc., to his customers;

(5) Broker's or finder's fees were not prohibited during the period charged to have been unlawfully included by the defendant as an item to be included in defendant's net unit cost;

(6) By including return freight on empty beer bottles and finder's fees in the net unit cost of the eastern beer no increase in profit was afforded to the defendant on his sales of said eastern beer; [25]

(7) In determining upon the meaning to be given the maximum price regulations applicable in these proceedings, the Court has been mindful of the provisions of the Emergency Price Control Act that its purpose, among others, is to eliminate and prevent profiteering and that it enjoins any order or regulation requiring the determination of costs otherwise than in accordance with established accounting methods;

(8) The emergency price control act is primarily designed to prevent inflation by controlling profit through the establishment of a cost-profit ratio equivalent to that which existed during the so called "base period";

(9) The Act contemplates increases in costs with resulting increases in ultimate prices, but intends that profits shall not increase;

(10) The maximum price regulations pertinent

to this case appear to be intended to limit the profit of a seller (the defendant in this case) to that made by him on comparable transactions during the month of March, 1942.

In view of the foregoing, the Court is of the opinion that the defendant properly charged or included in his net unit cost the return freight on empty beer bottles and the broker's or finder's fees covered by the stipulation of the parties filed herein and that the contentions of the defendant as to the interpretation to be placed upon the maximum price regulations involved herein are correct.

Dated at Tucson, Arizona, this 29th day of March, 1946.

ALBERT M. SAMES

Judge.

[Endorsed]: Filed March 29, 1946. [26]

Title of District Court and Cause]

Minute Entry of Friday, March 29, 1946
(Tucson Division)

Honorable Albert M. Sames, United States District Judge, Presiding.

It Is Ordered that the proposed findings of fact and conclusions of law presented by counsel for defendant be approved and filed as the findings of fact and conclusions of law herein, and

It Is Further Ordered that the form of judgment presented by counsel for defendant be approved, entered, filed and spread upon the minutes as the judgment herein. [28]

In the District Court of the United States
for the District of Arizona

No. Civ. 273—Tucson

CHESTER BOWLES, Adminisrator, Office of
Price Administration,

Plaintiff,

vs.

PAUL MYERS,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

The above entitled cause coming on for hearing on the 19th day of November, 1945, pursuant to stipulation of the parties, and having been heard by the Court without a jury, the parties appearing through their respective Counsel, and after hearing argument on behalf of the parties, and being fully advised in the premises, the following findings of fact and conclusions of law constituting the decision of said Court in said action are hereby made:

FINDINGS OF FACT

1. That the parties on the.....day of April, 1945 made and entered into a stipulation for judgment, which stipulation was approved by the Order of this Court on May 8, 1945, and was filed with this Court as a part of the record in this case;

2. That the facts set forth in said stipulation

are adopted by this Court as the facts upon which the decision of this Court is based, and that said stipulation and the exhibits attached thereto are incorporated herein by reference and made a part hereof as fully as if set out herein verbatim.

From the foregoing facts the Court concludes:

CONCLUSIONS OF LAW

1. That pursuant to the provisions of Maximum Price Regulation No. 259, and in particular pursuant to Section 3(a) (Section 1499.3(a)) of the General Maximum Price Regulations (7 F.R. 3153), the Defendant was entitled to include as an item of his costs his freight paid on empty cases and containers which Defendant was required to return to the brewery in order to purchase the beer; and further was entitled to include as an item of his costs the broker's or finder's fee paid by him to purchase the beer; [29]

2. That pursuant to said stipulation for judgment, approved May 8, 1945, the parties by express agreement and stipulation agreed that upon determination by this Court of the issues submitted by said stipulation, judgment shall be entered for Plaintiff and against the Defendant for the benefit of the United States of America.

3. That Plaintiff is entitled to judgment against the Defendant in the sum of Eighteen Thousand Three Hundred Twenty Nine and 20/100 (\$18,329.20) Dollars, and that said judgment shall

be payable in accordance with paragraph 14 of said stipulation approved May 8, 1945.

JUDGMENT

Wherefor, it is Ordered, Adjudged and Decreed that the Plaintiff do have and recover from the Defendant the sum of Eighteen Thousand Three Hundred Twenty Nine and 20/100 (\$18,329.20) Dollars, which judgment shall be payable in the following manner, at the following times, unless the Defendant shall desire to sooner pay the same, to-wit:

One-third thereof payable on the entry of judgment, and in no event later than ten (10) days thereafter; one-third, together with accrued interest, to be payable on or before six (6) months from the date of said judgment; and the balance thereof, together with accrued interest, payable on or before one (1) year from the date of said judgment, provided that all deferred payments shall bear interest from date of judgment until paid at the rate of four (4%) per cent per annum. It is further Ordered that in the event that said Defendant shall pay or cause to be paid on or before the dates hereinabove provided, the amounts hereinabove provided, together with accrued interest, no process shall issue for the collection or enforcement of said judgment, or any action or proceeding whatever to enforce payment of the same shall be instituted or brought; that in event of default in making of any of the payments hereinabove provided, or any part thereof, promptly on the date hereinabove specified, the

whole of said judgment shall forthwith and without notice to said Defendant become immediately payable, any payment thereof may be enforced by the Plaintiff or and other proper agency or department of the Government of the United States, by any and all means provided by law for the collection and enforcement of judgment.

Done in open Court this 29th day of March, 1946.

ALBERT M. SAMES

Judge of the District Court.

[Endorsed]: Filed March 29, 1946. [30]

[Title of District Court and Cause.]

ORDER SUBSTITUTING ADMINISTRATOR'S SUCCESSOR AS PARTY TO ACTION

Upon motion of Paul A. Porter, and the stipulation on file herein, and for good cause appearing therefor,

It Is Hereby Ordered, that Paul A. Porter, Administrator of the Office of Price Administration, be substituted as the Plaintiff herein in the place of Chester Bowles.

Dated this 23rd day of May, 1946.

HOWARD C. SPEAKMAN

Judge.

[Endorsed]: Filed May 23, 1946. [32]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Paul Porter, Administrator of the Office of Price Administration, Plaintiff above named, hereby appeals to the Circuit Court of Appeals, for the Ninth Circuit, from the final judgment entered in this action on or about March 29, 1946.

Dated: Phoenix, Arizona, this 22nd day of May, 1946.

/s/ AUSTIN CLAPP

/s/ HERBERT H. BENT

/s/ DAVID O. BROWN

Attorneys for Plaintiff.

A copy of the above Notice of Appeal was mailed to Knapp, Boyle, Bilby & Thompson, 907-915 Valley National Building, Tucson, Arizona, this 22nd day of May, 1946.

/s/ DAVID O. BROWN

[Endorsed]: Filed June 3, 1946. [34]

[Title of District Court and Cause.]

DESIGNATION OF RECORD AND PROCEED-
INGS TO BE CONTAINED IN RECORD
ON APPEAL

To: Edward W. Scruggs, Clerk of the above Court, and Knapp, Boyle and Thompson, Attorneys for the defendant,—

Now comes Paul Porter, Administrator of the Office of Price Administration, plaintiff above named and appellant, by his attorneys, and designates the following records and proceedings in the above cause to be contained in the Record on Appeal:

1. Plaintiff's Complaint.
2. Defendant's Answer.
3. Stipulation.
4. Order Approving Stipulation.
5. Order for Judgment Against the Defendant.
6. Court's Memorandum.
7. Findings of Fact and Conclusions of Law and Judgment.
8. Order Substituting Administrator's Successor. [36]
9. Notice of Appeal.
10. This Designation.

Dated at Phoenix, Arizona this 11 day of July, 1946.

/s/ DAVID O. BROWN

/s/ HERBERT H. BENT

/s/ AUSTIN CLAPP

[Endorsed]: Filed July 11, 1946. [37]

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR FILING
AND DOCKETING RECORD ON APPEAL

Pursuant to Rule 73 (g), good cause appearing therefor, it is hereby ordered that the time for filing and docketing of record on appeal in the above entitled cause be extended to August 31, 1946.

Dated: July 12, 1946.

HOWARD C. SPEAKMAN

United States District Judge

[Endorsed]: Filed July 12, 1946. [39]

[Title of District Court and Cause.]

STATEMENT OF POINTS ON APPEAL

On the appeal taken by the plaintiff from the final judgment herein, plaintiff will urge and rely upon the following points:

1. The court erred in concluding as a matter of

law that pursuant to the provision of MPR No. 259, and in particular pursuant to Section 3 (a) (Sec. 1499.3(a)) of the General Maximum Price Regulation (7 F.R. 3153), the defendant was entitled to include, as an item of his costs, his freight paid on empty cases and containers which defendant was required to return to the brewery in order to purchase the beer; and further was entitled to include as an item of his cost, the broker's or finder's fee paid by him to purchase the beer.

2. That the court erred in failing to hold as a matter of law that defendant was not entitled to include as an item of his cost, either the freight paid by him on empty cases and containers, which defendant was required to return to the brewery in order to purchase beer, or the broker's or finder's fee paid by him to purchase the beer.

3. That the court erred in failing to award judgment for plaintiff for at least \$18,329.20, plus the freight paid by defendant on empty cases and containers which defendant was required to return to the brewery in order to purchase beer and the broker's or finder's fee paid by him to purchase the beer.

/s/ AUSTIN CLAPP,

/s/ WILLIAM B. WETHERALL,

/s/ DAVID O. BROWN.

[Endorsed]: Filed July 24, 1946. [41]

[Title of District Court and Cause.]

AFFIDAVIT OF SERVICE BY MAIL

State of Arizona,

County of Maricopa—ss.

I, Cecilia I. Schultz, being first duly sworn, depose and say: That I am a secretary in the Office of Price Administration, 17 West Van Buren, Phoenix, Arizona; that I have served defendant with Statement of Points on Appeal, by mailing copy thereof, postage prepaid, addressed to:

Knapp, Boyle, Bilby & Thompson, 907-915 Valley National Building, Tucson, Arizona, they being attorneys for defendant herein, this 23rd day of July, 1946.

/s/ CECILIA I. SCHULTZ,

Subscribed and sworn to before me this 23rd day of July, 1946.

JOHN L. BRINKERHOFF,

Notary Public in and for the County of Maricopa,
State of Arizona.

My commission expires Feb. 6, 1947.

[Endorsed]: Filed July 24, 1946. [42]

In the District Court of the United States
For the District of Arizona

United States of America,

District of Arizona—ss.

I, Edward W. Scruggs, Clerk of the District Court of the United States for the District of Ari-

zona, do hereby certify that I am the custodian of the records, papers and files of the said Court, including the records, papers and files in the case of Paul A. Porter, Administrator of the Office of Price Administration, Plaintiff, versus Paul Myers, Defendant, numbered Civ-273-Tucson on the docket of said Court.

I further certify that the attached pages, numbered 1 to 42, inclusive, contain a full, true and correct transcript of the proceedings of said cause and all the papers filed therein, together with the endorsements of filing thereon, called for and designated in the Designation of Record and Proceedings to be contained in Record on Appeal filed in said cause and made a part of the transcript attached hereto, as the same appear from the originals of record and on file in my office as such Clerk, in the City of Tucson, State and District aforesaid.

I further certify that the Clerk's fee for preparing and certifying to this said transcript of record amounts to the sum of \$8.40, and that a memorandum of said sum has been entered in said cause by me for services rendered on behalf of the United States.

Witness my hand and the Seal of the said Court this 5th day of August, 1946.

[Seal] /s/ EDWARD W. SCRUGGS,

Clerk. [43]

United States Circuit Court of Appeals
In and for the Ninth Circuit

No. 11405

PAUL PORTER, ADMINISTRATOR, Office of
Price Administration,

Appellant,

vs.

PAUL MYERS,

Appellee.

STATEMENT OF POINTS ON APPEAL AND
DESIGNATION OF RECORD

Appellant hereby adopts as the points upon which he will rely in this Appeal the Statement of Points appearing in the Transcript of Record certified by the Court below.

The Clerk will please print the Record in this cause as designated in and certified by the Court below together with the above Statement and this Designation.

/s/ AUSTIN CLAPP,

/s/ WILLIAM B. WETHERALL,

/s/ DAVID O. BROWN,

Attorneys for Appellant.

[Endorsed]: Filed Sept. 7, 1946.

[Title of Circuit Court of Appeals and Cause.]

AFFIDAVIT OF SERVICE BY MAIL

State of California,

City and County of San Francisco—ss.

Mary Y. Cohen, being first duly sworn, says:
That affiant is a citizen of the United States and a resident of the City and County of San Francisco; that affiant is over the age of eighteen years and is not a party to the within and above entitled action; that affiant's business address is c/o Office of Price Administration, San Francisco Regional Office, 1355 Market Street, San Francisco 3, California; that on the 6th day of September, 1946, affiant served the attached Statement of Points on Appeal and Designation of Record upon the Appellee in said action by placing a copy thereof in a franked envelope addressed to Appellee's counsel of record at the office address as follows:

Knapp, Boyle & Thompson, Valley National Building, Tucson, Arizona.

and by then sealing said envelope and depositing the same, franked as aforesaid, in the United States mail at San Francisco, California.

That there is delivery service by United States mail at the place so addressed, and there is a regular

communication by mail between the place of mailing and the place so addressed.

/s/ MARY Y. COHEN.

Subscribed and sworn to before me this 6th day of September, 1946.

[Seal] JAMES S. MULVEY,
Notary Public in and for the City and County of
San Francisco, State of California.

My commission expires Oct. 7, 1946.

[Endorsed]: Filed Sept. 7, 1946.

[Endorsed]: No. 11405. United States Circuit Court of Appeals for the Ninth Circuit. Paul A. Porter, Administrator of the Office of Price Administration, Appellant, vs. Paul Myers, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Arizona.

Filed August 14, 1946.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 11405

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

**PAUL A. PORTER, ADMINISTRATOR, OFFICE OF PRICE
ADMINISTRATION, APPELLANT**

v.

PAUL MYERS, APPELLEE

APPELLANT'S BRIEF

GEORGE MONCHARSH,
Deputy Administrator for Enforcement,
DAVID LONDON,
Director, Litigation Division,
ALBERT M. DREYER,
Chief, Appellate Branch,
NATHAN SIEGEL,
Special Appellate Attorney,
Office of Price Administration,
Washington 25, D. C.

WILLIAM B. WETHERALL,
Regional Litigation Attorney,
Office of Price Administration,
San Francisco 8, California.

FILED

DEC 12 1948

SAN FRANCISCO

INDEX

	Page
Jurisdiction.....	1
Statement of the case.....	2
Issue on appeal.....	6
Specifications of error.....	6
Argument.....	7
The applicable regulations were violated where a wholesaler of beer made a charge for freight on cases and containers returned to a brewery, for broker's commissions and finder's fees where such charges were not made during its base period on sales of "comparable" beer and where defendant adduced no proof to show that subsequently his new supplier's maximum prices as fixed by the Office of Price Administration included such charges.....	7
Conclusion.....	26
Appendix: Applicable provisions, Statute and Regulations.....	27

TABLE OF AUTHORITIES

Cases:

<i>Batson v. Porter</i> , 154 F. 2d 566 (C. C. A. 4th).....	11
<i>Bowles v. Mannie & Co.</i> , 155 F. 2d 129 (C. C. A. 7th), certiorari denied Oct. 14, 1946.....	21
<i>Bowles v. Nu Way Laundry Co.</i> , 144 F. 2d 741 (C. C. A. 10th), cert. denied 65 S. Ct. 431.....	23
<i>Bowles v. Sanden & Ferguson</i> , 149 F. 2d 320 (C. C. A. 9th).....	21
<i>Bowles v. Seminole Rock & Sand Co.</i> , 325 U. S. 410.....	23
<i>Bowles v. Willingham</i> , 321 U. S. 503.....	24
<i>Galban Lobo Co. v. Henderson</i> , 132 F. 2d 150 (E. C. A.), certiorari denied 63 S. Ct. 530.....	23
<i>Gold-Form, Inc., v. Bowles</i> , 152 F. 2d 107 (E. C. A.).....	11
<i>Henderson v. Burd</i> , 133 F. 2d 515 (C. C. A. 2d).....	21
<i>Kortz v. Guardian Life Ins. Co.</i> , 144 F. 2d 676 (C. C. A. 10th), certiorari denied 323 U. S. 728.....	18
<i>National Labor Relations Bd. v. National Motor B. Co.</i> , 105 F. 2d 652 (C. C. A. 9th).....	18
<i>National Labor Relations Bd. v. G. Boswell Co.</i> , 136 F. 2d 585 (C. C. A. 9th).....	18
<i>Pacific Gas Corporation v. Bowles</i> , 153 F. 2d 453 (E. C. A.).....	11
<i>Philadelphia Coke Co. v. Bowles</i> , 139 F. 2d 349 (E. C. A.).....	20, 23
<i>Porter v. Crawford & Doherty Foundry Co.</i> , 154 F. 2d 431 (C. C. A. 9th), certiorari denied October 14, 1946.....	11
<i>United States Gypsum Co. v. Brown</i> , 137 F. 2d 803 (E. C. A.), certiorari denied 320 U. S. 799.....	23

II

Cases—Continued

	Page
<i>United States v. Pepper Bros.</i> , 142 F. 2d 340 (C. C. A. 3d)	21
<i>Yakus v. United States</i> , 321 U. S. 414	24

Statutes and Regulations:

Emergency Price Control Act, 56 Stat. 23, 50 U. S. C. App. Supp. II, Sec. 901 et seq., as amended, 58 Stat. 637, 50 U. S. C. App. Supp. IV, V, Sec. 925 (e)	1
General Maximum Price Regulation (7 F. R. 3153)	28
Maximum Price Regulation No. 259 (7 F. R. 8950)	2
Revised Maximum Price Regulation No. 259 (9 F. R. 14537, as amended 9 F. R. 15107)	13, 29

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11405

PAUL A. PORTER, ADMINISTRATOR, OFFICE OF PRICE
ADMINISTRATION, APPELLANT

v.

PAUL MYERS, APPELLEE

APPELLANT'S BRIEF

JURISDICTION

This is an appeal by the Price Administrator from a judgment of the United States District Court for the District of Arizona in an action by the Price Administrator for statutory damages under Section 205 (e) of the Emergency Price Control Act.¹

Judgment was entered on March 29, 1946 (R. 28). Notice of Appeal was filed June 3, 1946 (R. 30). Jurisdiction of the District Court was invoked under Section 205 (e) and 205 (c) of the Act (R. 2) and jurisdiction of this Court is invoked under Sec. 128 of the Judicial Code (28 U. S. C. 225).

¹ 56 Stat. 23, 50 U. S. C. App. Supp. 11, Sec. 901 et seq. as amended. 58 Stat. 637, 50 U. S. C. App. Supp. IV, V, Sec. 925 (e).

STATUTE AND REGULATIONS INVOLVED

This appeal involves Section 205 (e) of the Emergency Price Control Act of 1942 as amended; Maximum Price Regulation No. 259 (7 F. R. 8950) which establishes maximum prices for domestic malt beverages and the General Maximum Price Regulation (7 F. R. 3153). Pertinent provisions are set forth in the Appendix to this brief, pp. 26 to 32.

STATEMENT OF THE CASE

Defendant is engaged in buying, selling, distributing, and otherwise dealing in domestic malt beverages as a wholesaler (R. 11). As such, defendant is subject to the provisions of Maximum Price Regulation (MPR) No. 259 (7 F. R. 8959) which became effective November 1, 1942 (R. 11). This regulation superseded the General Maximum Price Regulation (GMPR), (7 F. R. 3153) which had previously held sellers of domestic malt beverages to their March 1942 prices. Section 1420.51 of MPR 259 contains a prohibition against sales of domestic malt beverages above maximum prices set forth in Appendix A of Section 1420.66 of the regulation. (See Appendix to brief p. 28.) Section 1420.66, Appendix A (a) of MPR 259 gave the wholesaler a choice of establishing maximum prices either as of the period October 1 to 15, 1941 inclusive, plus permitted increases set forth in a schedule in paragraph (c) (1) of the Section, or the maximum price established by such wholesaler under the provisions of the General Maximum Price Regulation (GMPR) "plus the 'permitted increase'

for excise taxes only” as specified in paragraph (c) (2) of that Section. (See Appendix, p. 28.)

The complaint charged that between December 1, 1943, and August 26, 1944, defendant violated MPR 259 in his sales of domestic malt beverages at prices in excess of those established by MPR 259 and judgment was demanded in the sum of \$28,691.74 (R. 2-5). In his answer, defendant denied the charges of violation; claimed that his sales were at prices which were computed in accordance with business and cost practices established in the industry *prior* to the enactment of the Emergency Price Control Act; and that if committed, the violations were neither wilful nor the result of failure to take practicable precautions (R. 7-9). No trial was had at which evidence was taken, but the parties stipulated the material facts and contentions (R. 10-18).

It was stipulated that the month of March 1942 shall be considered as the base period for the purpose of determining maximum prices and that the proper method of computing maximum prices on brands of beer not sold or offered for sale by defendant during March 1942, but offered for sale and sold by him for the first time subsequent to March 1942, shall be as provided by Section 3 (a) (Section 1499.3 (a)) of the General Maximum Price Regulation (R. 12). Section 3 (a) provides a formula by which a wholesaler may determine his maximum price and requires the seller before the commodity is offered for sale, to report such price to the appropriate field office of the Office of Price Administration. A maximum price so reported

may not be changed by the seller without authority to do so, even though the cost of the commodity increases. (See Appendix, p. 31.)

It was further stipulated that during March 1942 defendant was engaged exclusively in the sale at wholesale of ABC beer and ale, products of Aztec Brewing Company, Inc. of San Diego, California; and it was agreed that for the purposes of determining the maximum price of brands of beer *other* than ABC beer and ale the products of Aztec Brewing Company, Inc. actually handled by defendant during March 1942 shall be considered the "comparable commodity" (R. 12).

It was then stipulated that during the month of March 1942, the cost of return freight on empty bottles and cases was absorbed by Aztec Brewing Company, and not charged to defendant nor paid by him as such and further that during the month of March 1942, the defendant paid no brokerage commissions or finder's fees in connection with the purchase of any malt beverage handled by him during that month (R. 13-14).

Finally, it was stipulated that in computing the overcharges to be \$27,426.14 for the period mentioned in the complaint, the Administrator made no allowance for return freight to the brewery on empty cases and bottles or brokerage commissions or finder's fees paid by defendant in connection with the purchase and sale of the commodities for the reason, among others, that no such freight or commissions were paid during the base period by defendant in connection

with the “comparable commodity” being sold during that period (R. 13).

The parties agreed that the overcharges of \$27,426.14 were to be reduced to (a) \$23,202.84 or to (b) \$18,329.20 ² depending upon whether the Court found either (a) that “return freight” or that (b) *both* return freight and brokers’ commissions and fees paid in connection with the commodities constituted proper elements of net unit cost for the purpose of computing maximum prices under the regulation (R. 15–16).

After a hearing, consideration of the pleadings and stipulated facts, the court below rendered an opinion in which it ruled that judgment should be entered for \$18,329.20 (the smallest amount stipulated for by the parties) for many reasons which will be discussed hereafter (R. 23–25). The court made findings of fact in which it adopted the facts stipulated as the facts upon which it based its decision (R. 26–27), and likewise filed conclusions of law in which it held that under the provisions of MPR 259 and the GMPR, the defendant was entitled to include as an item of his costs freight paid on empty containers returned to the brewery and broker’s commissions and fees; and that pursuant to stipulation the Administrator was entitled to judgment of \$18,329.20 (R. 27–28). From this judgment the Administrator appeals (R. 30).

² That is, the amount of \$27,426.14 arrived at by the Administrator was to be reduced by \$4,223.30 if return freight alone was a proper element of net unit cost, and by \$9,086.14 if both return freight and commissions were proper elements of unit cost (R. 15).

ISSUE ON APPEAL

The sole issue on appeal is one of law. It is whether the court erred in concluding as a matter of law that in determining his maximum prices under the provisions of MPR 259 and the GMPR, defendant was entitled to include, as an item of his costs, freight paid on empty cases and containers which defendants returned to the brewery, and likewise broker's or finder's fees paid by him to purchase the beer, where it is undisputed that such costs and charges were absorbed by the seller during the base period and where defendant adduced no proof to show that subsequently his new supplier's maximum prices as fixed by the Office of Price Administration included such charges.

SPECIFICATIONS OF ERROR

1. The court erred in concluding as a matter of law that pursuant to the provision of MPR No. 259, and in particular pursuant to Section 3 (a) (Sec. 1499.3 (a)) of the General Maximum Price Regulation (7 F. R. 3153), the defendant was entitled to include, as an item of his costs, his freight paid on empty cases and containers which defendant was required to return to the brewery in order to purchase the beer; and further was entitled to include as an item of his cost, the broker's or finder's fee paid by him to purchase the beer.

2. That the court erred in failing to hold as a matter of law that defendant was not entitled to include as an item of his cost, either the freight paid by him on empty cases and containers, which defendant was

required to return to the brewery in order to purchase beer, or the broker's or finder's fee paid by him to purchase the beer.

3. That the court erred in failing to award judgment for plaintiff for at least \$18,329.20, plus the freight paid by defendant on empty cases and containers which defendant was required to return to the brewery in order to purchase beer and the broker's or finder's fee paid by him to purchase the beer.

ARGUMENT

The applicable regulations were violated when a wholesaler of beer made a charge for freight on cases and containers returned to a brewery, for broker's commissions and finder's fees where such charges were not made during its base period on sales of "comparable" beer, and where the defendant adduced no proof to show that subsequently his new supplier's maximum prices as fixed by the Office of Price Administration included such charges

The defendant admittedly sold beer after the effective dates of MPR 259 and the GMPR at prices higher than the highest price at which it sold comparable beer during March, 1942, its base period. The difference between its base period prices and its subsequent prices covered the freight cost for return of empty cases and bottles to the brewery, brokerage commissions and finder's fees, none of which charges were paid by the buyer on "comparable" beer during the base period and all of which were absorbed by the supplier during this period. The sole question here is whether the regulation permitted these additional charges to be made where they were not made during the base period, and where defendant failed to prove

that subsequent to the base period, his new supplier's maximum prices as fixed by the Office of Price Administration included such charges.

It was stipulated that March, 1942, be considered as the base period and that the proper method of computing the maximum prices on brands of beer not sold by defendant during the base period, but sold for the first time subsequent to March, 1942, shall be as provided by Section 3 (a) (Section 1499.3 (a) of the GMPR). A seller is relegated to Section 3 (a) of the GMPR if he is unable to use Section 2 (1499.2) of that regulation. Section 1499.2 of the GMPR provides that the seller's maximum price for any commodity shall be the highest price charged for the same commodity during March 1942. If the seller did not deal in the same or similar commodity, Section 1499.2 provides that the seller's maximum price shall be the highest price charged during March 1942, by the most closely competitive seller of the same class for the same commodity, and if no charge was made for the same commodity, for the similar commodity most nearly like it (see p. 30, *infra*). If the seller's maximum price for the commodity cannot be priced under Section 1499.2 of the GMPR, the seller must determine his maximum price according to a formula provided by Section 1499.3. By stipulation, as shown above, defendant's sales without dispute fall within Section 3 (a) (1499.3) of the GMPR. This Section provides in part as follows:

(a) *Sales at wholesale or retail.* In the case of a sale at wholesale or retail, the seller (1)

shall select from the same general classification and price range as the commodity being priced under this section, the comparable commodity for which a maximum price is established under § 1499.2 of this General Maximum Price Regulation and of which the seller delivered the largest number of units during March 1942; (2) shall divide his maximum price for that commodity by his replacement cost of that commodity; and (3) shall multiply the percentage so obtained by the cost to him of the commodity being priced under this paragraph. The resulting figure shall be the maximum price of the commodity being priced. Within ten days after determining such maximum price under this paragraph, the seller shall report such price to the appropriate field office of Price Administration upon a form, duly filled out and signed under oath or affirmation, copied from the form contained in § 1499.24, Appendix A, of this General Maximum Price Regulation. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.

“Replacement cost” is defined as follows:

(n) “Replacement cost” shall be the net price paid by the seller after May 18, 1942, or the net price which the seller would have to pay to replace such commodity after such date.

Section 1499.3 (a) is designed to allow to the seller as a mark-up, the percentage differential between the seller's maximum price for the comparable commodity dealt in by him during March, and his supplier's maximum price to him for replacement of that article.

It was stipulated that during the month of March

1942, the cost of returned freight on empty bottles and cases was absorbed by Aztec Brewing Company (the supplier) and was not charged to the defendant nor paid by him as such, and further that during the month of March 1942, defendant paid no brokerage commissions or finder's fees in connection with the purchase of any malt beverage handled by him during said month (R. 13-14). Under the provisions of MPR 259, if a seller or supplier made no charges for returned freight on empty bottles and cases during the base period, and also imposed no brokerage commissions or finder's fees, it was bound by that practice in its subsequent transactions, unless it obtained authority from the Office of Price Administration to make these extra charges. Defendant, however, made no such showing and from his answer, it does not appear that he relied on the theory that his new supplier was authorized to include freight returns and broker's and finder's fees. That being the case, and in the absence of any evidence in the record that defendant's new suppliers had authority to include these charges in its prices to defendant, the latter could not lawfully pay these charges to the supplier after the regulation became effective. By the same token, defendant's "net price," within the meaning of Section 3 (a) of the GMPR, could not properly include these charges. Obviously, "net price" does not mean the net price paid by the seller to the supplier irrespective of the character of the charges. Net price can mean

only legal net price and include only lawful charges.³ Otherwise, in a tight market, a supplier could charge a wholesaler any number of additional charges which the latter would “joyfully” pay (cf. *Porter v. Crawford & Doherty Foundry Co.*, 154 F. 2d 431, 434 (C. C. A. 9th) certiorari denied October 14, 1946) on the theory that those charges could always be included in the formula provided by Section 3 (a) of the GMPR, and thereby passed on to the purchaser. On that basis, a wholesaler could even be reimbursed for unlawful “side” payments made to a supplier. Such a construction of the regulation cannot be accepted, for it would thwart the manifest purposes of the Act in curbing inflation and operate as an invitation by every seller to violate (cf. *Batson v. Porter*, 154 F. 2d 566, 568 (C. C. A. 4th)).

³ Sec. 302 (i) of the Act defines “maximum price” as the “maximum *lawful* price” for a commodity.

In *Gold-Form, Inc., v. Bowles*, 152 F. 2d 107, 111 (E. C. A.), the court said:

“In the absence of a showing that the prices which these competitors were alleged to be charging for a similar garment were established *in accordance with the pricing rules contained in the regulation*, there is no basis for complainant’s contention that the price for its garment should be fixed in line with the level of the prices of these competitors.” [Italics ours.]

And in *Pacific Gas Corporation v. Bowles*, 153 F. 2d 453, 456 (E. C. A.), the court said:

“Moreover, complainant did not show that Warren’s maximum prices, which complainant had allegedly adopted pursuant to Section 5.3, were maximum prices which Warren had *properly* determined under Section 5.2.” [Italics ours.]

There is persuasive proof in the history of MPR 259 to rebut the notion that the defendant made a lawful charge for return freight on empty bottles and cases and broker's commissions or finder's fees in this case.

In the initial form of MPR 259, the increases to be added to maximum prices established by the General Maximum Price Regulation (if that was the pricing method chosen by the seller) were the "permitted increases for excise taxes only." On its face, therefore, the regulation did not permit any additional charges to be made for return freight or broker's or finder's fee between December 1, 1943, and August 26, 1944, the period of violation charged in the complaint (R. 3). On December 12, 1944, the Price Administrator reaffirmed this intention with the issuance of Revised Maximum Price Regulation 259 (9 F. R. 14537), which superseded Maximum Price Regulation 259. Section 5.9 (a) of RMPR 259 forbade sales of beer at prices above the maximum prices established by the regulation (*infra*, p. 29). Section 5.9 (b) (1) carried a general prohibition against evasion "by commission, brokerage or finder's fee, service, transportation or other charge * * *" and Section 5.9 (b) (2) contained specific acts which constituted an evasion. Among these was Section 5.9 (b) (2) (iii), which read as follows:

Making a separate charge by a seller to a purchaser for local hauling or handling, loading or unloading, for breakage of barrels, containers or cases, for reconditioning barrels, containers or cases, or *for hauling or handling empty barrels, containers or cases.* [Italics ours.]

The Statement of Considerations accompanying this regulation provided the following explanation for this provision:

Certain other transactions or acts constituting violations or evasions of the new regulation are prohibited * * *. Finally, local hauling or handling, loading or unloading, breakage of barrels, containers or cases, or their reconditioning, hauling or handling, may not be made the subject of separate charge. *Maximum prices contain compensation to the seller for normal expenses of that latter type.* In individual instances of exceptional expense of that nature, its origin is generally a change in normal marketing practice the seller has found it desirable to make. Acceptance of benefits of such change should carry with it corresponding burdens. [Italics ours.]

Up to that point, the regulation still made no provision for inclusion of transportation charges on the return of cases and empty containers as an element of the cost of acquisition, since it was commonly known and accepted that maximum prices included compensation to the seller “for normal expenses” of that type. The first instance where “transportation charges” are defined by the Administrator to include charges for the return of empties appears on December 27, 1944, when Amendment 2 was issued to Revised Maximum Price Regulation 259 (9 F. R. 15107) amending Section 1.2 (n) of that regulation (now Sec. 1.2 (p)) by adding the following paragraph at the end thereof:

The term “transportation charges” shall also include charges for the return of cases and

empty containers, *only where the seller imposed such a charge on a particular class of purchaser during the applicable base period or where the seller did not ship outside his local area during the applicable base period and now establishes a maximum price to a new class of purchaser located outside his local area* * * *. [Italics ours.]

The Statement of Considerations which accompanied this amendment indicates clearly that while it was a customary practice during the base period for some producers and some sellers of beer to require purchasers to pay transportation charges incident to the return of cases and empty containers, *that the regulation made no provision for the inclusion of such charges as an element of the cost of acquisition.*⁴ By

⁴ The statement of considerations read in part as follows: "The attention of the Price Administrator has been directed to the fact that it was the customary practice during the base period for some brewers and other sellers of malt beverages to require purchasers to pay transportation charges incident to the return of cases and empty containers, and that those purchasers historically included as part of their cost the return freight charges thus paid.

The regulation, however, made no provision for the inclusion of the transportation charges incurred on the return of cases and empty containers as an element of the cost of acquisition to which the markup factor is applied. A review of the results of the Bureau of Labor Statistics Survey indicates that the margins were computed from a base cost which includes as an element of cost, return freight on cases and empty containers. Consequently, in order properly to reflect the results of the Bureau of Labor Statistics Survey, appropriate provision has been made to permit sellers to include in their cost of acquisition return freight on "empties" *where that charge was imposed on them during the base period or where the seller during the base period sold only in his local area and now establishes a maximum price to a new class of customer located outside that area.*" [Italics ours.]

this amendment, however, appropriate provision was being made to permit sellers to include in their cost of acquisition "returned freight on empties," but "only where the seller imposed such a charge * * * during the applicable base period."

Similarly, as shown above, at no time were brokerage commissions or finder's fees permissible under the regulation which were not paid in the base period. MPR 259 was express in its provisions to prevent the use of brokers to shift to purchasers those selling expenses which the seller's maximum price usually covered.

It was to cope with this kind of practice that Section 1420.57 (a) was included in MPR 259. That section read as follows:

Evasion. (a) The price limitations set forth in this Maximum Price Regulation No. 259 shall not be evaded, whether by direct or indirect methods, in connection with an offer, solicitations, agreement, sale or delivery of, or relating to the sale of domestic malt beverages alone or in connection with any other commodity, or by way of *commission, service, transportation* or any charge, or discount premium or other privilege, or by tying-agreement or other trade understanding or otherwise. [Italics ours.]

The disruptive effect upon price control of brokerage activities having their origin in supply shortage was likewise noted when Revised Maximum Price Regulation 259 superseded MPR 259 on December 12, 1944 (9 F. R. 14537). Provision was made for payment to brokers in Section 5.3 under certain circum-

stances, with an admonition that the broker was to be “considered the agent of the seller, not the agent of the purchaser.”⁵

The Statement of Considerations said the following respecting this provision:

The new regulation contains provisions designed to prevent use of brokers to shift to purchasers selling expenses which the seller's maximum price is designed to cover. The Price Administrator has previously had occasion to discuss the disruptive effect of brokerage activities having their origin in supply shortage and the considerations motivating action to prevent that result need not be repeated * * *. Newly initiated practices of that character ordinarily result in the seller's receiving and the purchaser's paying a consideration in excess of the applicable maximum price or involve evasion of the regulation * * *.

On the basis of the stipulated facts in this record, the plain language of the regulation, and sound considerations supporting it, there can be little question but that the price limitations set forth in MPR 259

⁵ SEC. 5.3 *Payment of brokerage.* Every broker shall be considered the agent of the seller, and not the agent of the purchaser. In each instance, the amount paid by the purchaser to the seller, plus any amount paid by the purchaser to the broker, shall not exceed the seller's maximum price including allowable charges actually paid by the seller or by the broker. In other words, the seller may not collect from the purchaser any more than the maximum price including allowable charges, less any amount the purchaser pays the broker. * * *

As used in this section, “broker” means a person acting as intermediary between a seller and a purchaser. It includes, but is not restricted to, a “finder,” “buyer's agent,” and “seller's agent.”

were being evaded by defendant either directly or indirectly by way of both "commission" and "transportation * * *." (Sec. 1420.57 (a).)

However, for many reasons which we will now discuss, the court below refused to adopt the fair and reasonable construction of the regulation which the Administrator had consistently placed upon it, or to give any weight to the statements of considerations which were in harmony with it.

Consideration of reasons assigned by court below

(1) The court declared that "net unit cost includes any cost lawfully charged by a supplier and paid by a seller such as the defendant herein" (R. 23). We concede the correctness of this statement. The question is, does it apply to defendant's sales in this case? Defendant adduced no proof whatever to show that the supplier charged the defendant with the cost of return freight on empty bottles or with brokerage commissions or finder's fees, and defendant also failed to show that the supplier was authorized by the Office of Price Administration to make such charges. Yet, that was a burden which defendant was obliged to discharge after the Administrator had made out a prima facie case by showing that the cost of returned freight on empty bottles and cases was "absorbed" by the supplier during the base period, "and not charged to said defendant nor paid by him" and further that during that period, the defendant paid the supplier no brokerage commissions or finder's fees in connection with its purchases of malt beverage

(R. 13-14). Under familiar principles, in the absence of evidence to the contrary, we must presume that a condition which has been shown to exist, has continued. (*National Labor Relations Bd. v. National Motor B. Co.*, 105 F. 2d 652, 660 (C. C. A. 9th); *Kortz v. Guardian Life Ins. Co.*, 144 F. 2d 676, 678 (C. C. A. 10th), certiorari denied, 323 U. S. 728;⁶ *National Labor Relations Board v. J. G. Boswell Co.*, 136 F. 2d 585, 589 (C. C. A. 9th).)

(2) The court's second reason is that "defendant's new supplier's maximum price as fixed by the Office of Price Administration included return freight on empty beer bottles, and such new supplier property charged return freight on empty beer bottles" (R. 23). This record will be searched from end to end in vain for even the semblance of any proof that defendant's supplier obtained authority from the Office of Price Administration to increase its prices as to include return freight on empty beer bottles. And the record is equally barren of proof that the new supplier "properly" charged defendant with return freight on empty beer bottles and containers. As has been indicated at pages 12 to 13, such charges were not per-

⁶ In *Kurtz v. Guardian Life Ins. Co.*, *supra*, the court said:

"Though the judgment in the former action does not constitute *res judicata* or an estoppel here, the pleadings and judgment were admissible in evidence as proof of the existence of disability at that time. The insured introduced in evidence copies of the complaint and the judgment. And they constituted a conclusive showing of disability at that time, gave rise to a presumption that it continued in the future, and *shifted the burden to the company to go forward and show by a preponderance of the evidence that the condition no longer existed.*" [Italics ours.]

missible prior to December 27, 1944. Hence, if the supplier imposed these charges prior to that time, they were unauthorized under the regulation and, therefore, were not lawful charges to be included in defendant's net cost.

(3) For the reasons discussed above under (1) and (2), the court's statement that "the return freight on empty beer bottles as charged by the new supplier is an item to be included in the defendant's net unit cost" cannot be sustained.

(4) For its fourth reason, the court declared that defendant, though including return freight on empty beer bottles, and though including finder's fees in fixing his maximum price on the new commodity as items of net unit cost, nonetheless continued his customary allowance, discounts, etc., to his customers (R. 24). We fail to see the materiality of this reason. Whether or not defendant continued his customary allowances and discounts to his customers on sales of beer subsequent to the base period, is of no relevancy to the question in dispute as to whether he could charge for return freight and broker's commissions and finder's fees.

(5) As a fifth reason, the court states that "broker's or finder's fees were not prohibited during the period charged to have been unlawfully included by the defendant as an item to be included in defendant's net unit cost" (R. 24). The regulation did not permit broker's commissions or finder's fees, and unless defendant can show that its supplier was authorized by the Office of Price Administration to include such

charges in its sales to defendant, defendant could not include these charges in its net unit cost. Needless to say, proof on this score was lacking.

(6) Nor is it of any materiality that defendant failed to increase its profits by including return freight on empty beer bottles and finder's fees in the net unit cost of the eastern beer (Reason 6, R. 24). The test in determining whether a regulation has been violated is not whether a seller has profited from a transaction. The sole test is whether the commodity is being sold in excess of the ceiling price established by the regulation. "The Act does not require * * * that a regulation shall protect each individual member of the industry in the enjoyment of his customary profits" (*Philadelphia Coke Co. v. Bowles*, 139 F. 2d 349, 355) (E. C. A.). On the theory suggested by the District Court, there could be no violation in any part of the chain of sellers, since each could pass on to the other an overcharge made in the first instance in order to preserve the normal profit. Plainly, if this were the case, there could be no price control.

(7) Equally lacking in merit is the reason assigned by the court below that the purpose of the Act is to eliminate and prevent profiteering, and that it "enjoins any order or regulation requiring the determination of costs otherwise than in accordance with established accounting methods" (R. 24). The court was obviously referring to Section 2 (h) of the Act, which provides as follows:

The powers granted in this section shall not be used or made to operate to compel changes in the business practices, cost practices or

methods, or means or aids to distribution, established in any industry, * * *.

Proof that a particular regulation issued by the Administrator produces the effects forbidden by Section 2 (h) would require a holding that the regulation is invalid. The validity of a regulation is, however, a matter which lies within the exclusive jurisdiction of the Emergency Court of Appeals and cannot be litigated in this proceeding. In this court, the regulation must be accepted as valid (*Bowles v. Sanden & Ferguson*, 149 F. 2d 320, 321 (C. C. A. 9th); *Henderson v. Burd*, 133 F. 2d 515, 517 (C. C. A. 2d); *United States v. Pepper Bros.*, 142 F. 2d 340, 343 (C. C. A. 3d); *Bowles v. Mannie & Co.*, 155 F. 2d 129, 133 (C. C. A. 7th), certiorari denied October 14, 1946).

(8) What was said of the court's sixth reason may be said of the court's eighth reason, that "the Act is primarily designed to prevent inflation by controlling profit * * *." The purposes of the Act are to check unwarranted *price* increases. It is not concerned with profit. The Statement of Considerations involved in the issuance of the General Maximum Price Regulation, under which the defendant in this case was supposed to determine its maximum prices, sets forth these purposes very clearly.

1. *Breadth of the Regulation.*—The imminence of price increases throughout the economy requires price control which is likewise made generally effective. There are inflationary pressures on prices everywhere. And so everywhere that prices exist there must be controls to prevent them from rising any further.

Retail prices cannot be held down if costs to retailers are left free to rise without limit. There must be control of manufacturers' and wholesalers' prices. And at all levels—retailer, wholesaler, and manufacturer—the control of the prices of cost-of-living items must be based upon control of the prices of all the commodities that enter into the costs of those items. The interdependence of prices, when prices are rising generally, prohibits any possibility of piecemeal control.

Even where prices do not affect each other directly, as costs, they affect each other indirectly. To control the price of more essential products and leave the price of less essential products uncontrolled at best involves arbitrary distinctions. A limited Regulation would obstruct the concentration of men and materials in the most important uses. In war, that concentration is of vital importance.

2. *The base period.*—The core of the General Maximum Price Regulation is its requirement that each seller charge no more than the prices which he charged during the base period, March 1–31, 1942. The basic fairness of this approach is that it catches hold of the price structure during a given period and holds it fast until a judgment can be made as to what adjustments, if any, are needed. The Regulation accepts the level and relationships of prices worked out by the buyers and sellers of the commodities at various economic levels. This is fair and reasonable. Certainly it is a sufficient basis for a price stop which is offered as a general regulation subject to future refinements and allowances for gross inequities.

And the authorities which have construed this regulation have consistently held that whether an individual is deprived of profit by impact of a wartime regulation is of no materiality (*Philadelphia Coke Co. v. Bowles*, 139 F. 2d 349 (E. C. A.); *United States Gypsum Co. v. Brown*, 137 F. 2d 803, 807 (E. C. A.) certiorari denied 320 U. S. 799; *Galban Lobo Co. v. Henderson*, 132 F. 2d 150, 152 (E. C. A.) certiorari denied 63 S. Ct. 530). We might add, however, that if the regulation in this case worked a hardship upon defendant, adequate remedies were provided in the regulations by which he could obtain an adjustment (cf. *Bowles v. Seminole Rock & Sand Co.*, 325 U. S. 410, 419. See also *Bowles v. Nu Way Laundry Co.*, 144 F. 2d 741, 748 (C. C. A. 10th) certiorari denied 65 S. Ct. 431).

(9) Our comment to the eighth reason applies as well to the court's ninth reason, that "the Act contemplates increases in costs with resulting increases in ultimate prices, but intends that profits shall not increase." The core of the General Maximum Price Regulation is its requirement that each seller charge no more than the prices which he charged during the base period. The seller is bound to this base period, even though wages, rents, taxes, or materials increase in price, unless and until he applies for and obtains an adjustment of prices (see cases cited p. 22). The basis of the General Maximum Price Regulation is that it "catches hold of the price structure during a given period and holds it fast till judgment can be made as to what adjustments, if any, are needed."

As indicated at pp. 21-22, *supra*, there is present in the regulation adequate leeway for future refinements and allowances for hardship cases, and the Supreme Court has indicated that this is a sufficient basis for a general regulation of this character (*Bowles v. Seminole Rock & Sand Co.*, *supra*; see also, *Bowles v. Willingham*, 321 U. S. 503; *Yakus v. United States*, 321 U. S. 414).

(10) In view of our previous discussion, no extended comment is necessary to the tenth reason of the court below that the "maximum price regulations pertinent to this case appear to be intended to limit the profit of a seller (the defendant in this case) to that made by him on comparable transactions during the month of March, 1942" (R. 24-25).

It is significant that although the court below assigned these ten reasons for arriving at his conclusion, when it came to filing its findings of fact, it did not say that the facts referred to in the reasons set forth in its *memorandum* are adopted as the facts in the case. Instead, the court merely declared that "the facts set forth in said *stipulation* are adopted as the facts upon which the decision of this Court are based" (R. 26-27). As we have shown, the stipulated facts do not have a single word in them to the effect that

"* * * The defendant's new supplier's maximum price as fixed by the Office of Price Administration included return freight on empty beer bottles and such new supplier properly charged return freight on empty beer bottles" (Reason 2, R. 23). Moreover, it will be noted that the District Court does not go so

far as to say that the defendant's new supplier's maximum price as fixed by the Office of Price Administration included not only return freight, but likewise, broker's commissions and finder's fees. As to the latter charges, the court merely declared that "broker's or finder's fees were not prohibited * * *" (Reason 5, R. 24), although there is nothing in the stipulated facts to support this statement either. The regulation forbade these brokerage charges, if not expressly, at least indirectly, by establishing as a maximum price those prices set forth in Section 1420.66 Appendix A, plus the "permitted increase" for *excise taxes only*. Hence, brokerage charges and finder's fees were not included in the "permitted increases," no more than return freight on empties, until the Office of Price Administration granted authority to do so, and this authority defendant failed to show was given.

In this connection it should also be noted that in his answer, defendant did not rely on the defense that the new supplier's maximum prices as fixed by the Office of Price Administration properly included the disputed charges. There, defendant merely denied the charges of violation; in general claimed that its sales were made at maximum prices; and then alleged that its prices "were computed in accordance with the business and cost practices established * * * in the industry *prior* to the enactment of said Emergency Price Control Act * * *" (R. 8-9). In view of the authorities cited at p. 20, this latter defense was of course plainly lacking in merit; as were also those

contentions adopted by the court below that defendant's right to profit was entitled to protection during a period of emergency.

CONCLUSION

The court below was clearly wrong as a matter of law in dismissing that portion of the complaint which charged defendant with violating the regulation by including in his prices the cost of returned freight on empty containers, broker's commissions and finder's fees. To that extent, it is respectfully submitted that the judgment below should be reversed with instructions to enter judgment for the full amount of the overcharges as stipulated in the record on appeal.

Respectfully submitted.

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APPENDIX

APPLICABLE PROVISIONS OF ACT

SEC. 205 (e) If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may, within one year from the date of the occurrence of the violation, except as hereinafter provided, bring an action against the seller on account of the overcharge. In such action, the seller shall be liable for reasonable attorney's fees and costs as determined by the court, plus whichever of the following sums is the greater: (1) Such amount not more than three times the amount of the overcharge, or the overcharges, upon which the action is based as the court in its discretion may determine, or (2) an amount not less than \$25 nor more than \$50, as the court in its discretion may determine: Provided, however, That such amount shall be the amount of the overcharge or overcharges or \$25, whichever is greater, if the defendant proves that the violation of the regulation, order, or price schedule in question was neither wilfull nor the result of failure to take practicable precautions against the occurrence of the violation. For the purposes of this section the payment or receipt of rent for defense-area housing accommodations shall be deemed the buying or selling of a commodity, as the case may be; and the word "overcharge" shall mean the amount by which the consideration exceeds the applicable maximum

price. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer either fails to institute an action under this subsection within thirty days from the date of the occurrence of the violation or is not entitled for any reason to bring the action, the Administrator may institute such action on behalf of the United States within such one-year period.

APPLICABLE PROVISIONS OF REGULATIONS

[A] *Maximum Price Regulation 259 (7 F. R. 3153)*

SEC. 1420.51. *Prohibition against sales of domestic malt beverages above maximum prices.* On and after November 1, 1942, regardless of any contract, agreement, lease or other obligation:

(a) No person shall sell or deliver any domestic malt beverages higher prices than the maximum prices set forth in Appendix A (§ 1420.66) of this Maximum Price Regulation No. 259. * * *

(c) No person shall agree, offer, solicit or attempt to do any of the foregoing: * * *

SEC. 1420.53. *Applicability of the General Maximum Price Regulation and other regulations or orders.*

(a) The provisions of this regulation supersede the provisions of the General Maximum Price Regulation with respect to sales and deliveries of domestic malt beverages for which maximum prices are established by this Regulation. However, this regulation shall not apply to sales of domestic malt beverages at retail in any area in which maximum prices for such sales have been or are hereafter fixed by the Regional Administrator or District Director of the Office of Price Administration in that area by special order is-

sued under General Order No. 50, or by any restaurant maximum price regulation. * * *

SEC. 1420.57 *Evasion.* (a) The price limitations set forth in this Maximum Price Regulation No. 259 shall not be evaded, whether by direct or indirect methods, in connection with an offer, solicitation, agreement, sale or delivery of, or relating to the sale of domestic malt beverages alone or in connection with any other commodity, or by way of commission, service, transportation, or any charge, or discount, premium or other privilege, or by tying-agreement or other trade understanding or otherwise. * * *

SEC. 1420.66 Appendix A—(a) *For manufacturers and wholesalers.* The maximum price which a manufacturer or wholesaler may charge for a domestic malt beverage, except in 32-ounce containers, shall be the highest price charged by him for such domestic malt beverage during the period October 1 to 15, 1941, inclusive, plus the “permitted increase” set forth in the schedule of permitted increases in paragraph (c) (1) of this section, or the maximum price now established by such manufacturer or wholesaler under the pricing provisions of the General Maximum Price Regulation, plus the “permitted increase” for excise taxes only as specified in paragraph (c) (2) of this section.

Provisions of Revised Maximum Price Regulation 259
(9 F. R. 14537, 15107)

SEC. 1.2 (n) *Transportation charges.* “Transportation charges” means the specific allowance provided in this regulation for the particular movement of the malt beverage being priced, or where no such allowance is provided, lawful charges of the cheapest available common or contract carrier for movement of the malt beverage being priced by the most direct route

from the seller's shipping point to the purchaser's customary receiving point. The term includes any applicable Federal tax on transportation now or hereafter imposed. However, charges for local hauling or handling are excluded.

SEC. 5.9 *Compliance with this regulation*—(a) *No selling or buying above maximum prices.* Regardless of any contract or obligation, no person shall sell or deliver, or buy or receive in the course of trade or business, any malt beverage at a price higher than the maximum price established by this regulation, and no person shall agree, offer, solicit or attempt to do any of the foregoing. However, a price lower than the maximum price may be charged or paid.

(b) *Evasion.* (1) No person shall evade a maximum price directly or indirectly, by any practice or device in connection with an offer, solicitation, agreement, sale, delivery, purchase or receipt of or relating to any malt beverage either alone or in connection with any other commodities or services, by commission, brokerage or finder's fee, service, transportation or other charge or discount, premium or other privilege, by tying or tie-in agreement, long term contract, combination sale or trade understanding, by any change in style or manner of packing, by a business practice relating to containers, or by any other means.

(2) The following transactions or acts constituting violations or evasions of this regulation are prohibited:

(i) Changes in kinds, grades and proportions of ingredients resulting in depreciation of the quality of a malt beverage other than as the result of a normal variation;

(ii) The reduction or elimination of a brewer's customary discounts, allowances or price differentials;

(iii) Making a separate charge by a seller to a purchaser for local hauling or handling, loading or un-

loading, for breakage of barrels, containers or cases, for reconditioning barrels, containers or cases, or for hauling or handling empty barrels, containers or cases.

[B] *General Maximum Price Regulation* (7 F. R. 3153)

§ 1499.1 *Prohibition against dealing in commodities or services above maximum prices.* On and after the effective date of this General Maximum Price Regulation, regardless of any contract or other obligation:

(a) No "person" shall "sell" or deliver any "commodity", and no person shall sell or supply any "service", at a price higher than the maximum price permitted by this General Maximum Price Regulation; and

§ 1499.2 *Maximum prices for commodities and services: General provisions.* Except as otherwise provided in this General Maximum Price Regulation, the seller's maximum price for any commodity or service shall be:

(a) In those cases in which the seller dealt in the same or similar commodities or services during March 1942:

The highest price charged by the seller during such month—

(1) For the same commodity or service; or

(2) If no charge was made for the same commodity or service, for the similar commodity or service, most nearly like it; or

(b) In those cases in which the seller did not deal in the same or similar commodities or services during March 1942:

The highest price charged during such month by the most closely competitive seller of the same class—

(1) For the same commodity or service; or

(2) If no charge was made for the same commodity or service, for the similar commodity or service most nearly like it.

“Highest Price Charged During March 1942”

For the purposes of this General Maximum Price Regulation, the highest price charged by a seller “during March 1942” shall be:

(a) The highest price which the seller charged for a commodity delivered or service supplied by him during March 1942; or

(b) If the seller made no such delivery or supplied no such service during March 1942 his highest offering price for delivery or supply during that month.

No seller shall change his customary allowances, discounts or other price differentials unless such change results in a lower price. The “highest price charged” shall be a price charged during March 1942 to a purchaser of the same class. But if during March 1942 a seller (1) had an established practice of making allowances, discounts or price differentials to different classes of purchasers, and (2) raised his general level of prices, but thereafter during March 1942 made no delivery to any purchaser of a particular class he shall, for that particular class of purchasers calculate the highest price charged by taking the highest price charged during March 1942 to a purchaser of another class and then adjusting such price to reflect his established allowances, discounts and price differentials. No seller shall require any purchaser, and no purchaser shall be permitted, to pay a large proportion of transportation costs incurred in the delivery or supply of any commodity or service, than the seller required purchasers of the same class to pay during March 1942 on deliveries or supplies of the same or similar types of commodities or services.

“Similar Commodities or Services”

One commodity shall be deemed “similar” to another commodity, if the first has the same use as the second, affords the purchaser fairly equivalent serviceability, and belongs to a type which would ordinarily be sold in the same price line. In determining the similarity of such commodities, differences merely in style or design which do not substantially affect use, or serviceability, or the price line in which such commodities would ordinarily have been sold, shall not be taken into account. One service shall be deemed “similar” to another service if the first has the same use and purpose as the second and belongs to a type which would ordinarily be sold for the same or substantially the same price.

§ 1499.3 *Maximum prices for commodities which cannot be priced under § 1499.2.* The seller’s maximum price for a commodity which cannot be priced under § 1499.2 of this General Maximum Price Regulation shall be a maximum price in line with the level of maximum prices established by this General Maximum Price Regulation. Such price shall be determined by the seller in accordance with the following procedures:

(a) *Sales at wholesale or retail.* In the case of a sale at wholesale or retail, the seller (1) shall select from the same general classification and price range as the commodity being priced under this section, the comparable commodity for which a maximum price is established under § 1499.2 of this General Maximum Price Regulation and of which the seller delivered the largest number of units during March 1942; (2) shall divide his maximum price for that commodity by his replacement cost of that commodity; and (3) shall multiply the percentage so obtained

by the cost to him of the commodity being priced under this paragraph. The resulting figure shall be the maximum price of the commodity being priced. Within ten days after determining such maximum price under this paragraph, the seller shall report such price to the appropriate field office of Price Administration upon a form, duly filled out and signed under oath or affirmation, copied from the form contained in § 1499.24, Appendix A, of this General Maximum Price Regulation. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.

No. 11405

In the
United States
Circuit Court of Appeals
For the Ninth Circuit

PAUL A. PORTER, Administrator,
Office of Price Administration,
Appellant,

vs.

PAUL MYERS,
Appellee.

Appellee's Brief

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TOPICAL INDEX

	Page
Statement of the Case.....	1
Argument	3
The Regulations	3
Freight Paid on Returned Empties.....	6
Commissions Paid to Brokers.....	11
Appellants Brief	16
Conclusion	22
Appendix	App. 1

TABLE OF CASES AND AUTHORITIES CITED

	Page
Clyde Equipment Co. v. Fronto, 16 Fed. (2nd) 106 (C. C. A., 9th).....	18
Gartner v. Hope, et al, 272 Fed. 896.....	18
G. M. P. R. No. 259, par. (p) of Sec. 1.2 Amend. 3	9
G. M. P. R. No. 259, Sec. 5.3 (Dec. 18, 1944).....	13
Kirby v. U. S. 273 Fed. 391 (C. C. A. 9th).....	20
Packing Co. v. Steamship Co., 22 Fed. (2nd) 12 (C. C. A., 9th).....	20
Pickney v. Railroad, 109 Atl. 700 245 U. S. 631; 65 L. Ed. 447, 41 S. Ct. 7.....	21
Railway v. Stewart, 245 U. S. 362, 62 L. Ed. 347, 38 S. Ct. 130.....	20
Rwy Express v. Lindenburg, 260 U. S. 584, 43 S. Ct. 206, 67 L. Ed. 414.....	20
Railroad v. Rankin, 241 U. S. 319, 36 S. Ct. 555, 60 L. Ed. 1022.....	20
Revised Maximum Price Reg. 165.....	14
Wellington v. Stratton, 11 Mass. 394, 395, 3 C. J. 610	21
Sec. 1499.3 G. M. P. R., 7 F. R. 3153.....	2, 5, 6, 11
Sec. 1420.66 G. M. P. R. (Nov. 2, 1942, App. A(a)	5
U. S. Code Congressional Service 1944, p. 617.....	4
U. S. Code Congressional Service 1942, p. 377, F. R. 3153.....	6
U. S. v. Eliason, 16 Peters 291, 10 L. Ed. 968.....	21

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Appellee's Brief

STATEMENT OF THE CASE

Appellee-defendant respectfully designates to the Court three matters in which the appellant's statement of the case is not wholly accurate or omits matters which appellee believes are material to a decision of the case.

1. By stipulation in the court below the parties agreed that the regulations governing pricing of the commodity sold by defendant was Section 1499.3, as

shown by 7 F. R. 3153. This section appellee sets out in the appendix hereto as being the correct version of this section. Through error or oversight the appellant, in his brief, on page 31, sets out a later revision of this section.

2. Appellee calls to the Court's attention the language of the stipulation made by the parties in the court below, which was, as it is designated, "Stipulation for Judgment." (Tr., p. 10.) In paragraph 9 of the stipulation the language is "the plaintiff has made no allowance for return freight to the brewery on empty cases and bottles or brokerage commissions or finder's fees *paid by said defendant.*"

The Court's attention is also called to paragraphs 11, 12 and 13 of the stipulation, whereby the parties agreed to a certain stipulated sum to be entered as a judgment against the defendant in the event of a decision by the court upon the facts stipulated.

3. Appellee further calls the Court's attention to Exhibits "A" and "B", attached to the stipulation (Tr., pp. 19, 21) wherein on September 14, 1945, the Office of Price Administration specifically approved of defendant's method of pricing his merchandise and advised defendant that this approval was "the official interpretation."

ARGUMENT

(In the argument made here appellant is referred to as plaintiff and the appellee is referred to as defendant.)

1. In determining his maximum selling price under Maximum Price Regulation No. 259 could defendant include as an item of his cost freight paid on empty cases and containers which the defendant had to return to the breweries in order to purchase the beer?

2. In determining his maximum selling price under Maximum Price Regulation No. 259, could defendant include as an item of his cost the broker's or finder's fee paid by him to purchase the beer?

THE REGULATIONS

The determination of these questions will depend entirely upon the interpretation which the Court gives to Section 1499.3(a) of General Maximum Price Regulation (7 FR 3153). It is stipulated that said section sets forth the proper method for computing the maximum price which defendant was entitled to charge on the brands of beer involved in these questions. See Section 6 of the Stipulation.

The authority for price control stems from the Emergency Price Control Act of 1942. The act created the Office of Price Administration and provided for the appointment of an administrator. Section 2(a) of such act provides in part that

“Sec. 2(a). Whenever in the judgment of the Price Administrator (provided for in section 201 (21)) the price or prices of a commodity or commodities have risen or threaten to rise to an extent or in a manner inconsistent with the purposes of this Act, he may by regulation or order establish such maximum price or maximum prices as in his judgment will be generally fair and equitable and will effectuate the purposes of this Act. . . . PROVIDED, *That no such regulation or order shall contain any provision requiring the determination of costs otherwise than in accordance with established accounting methods.*” . . . (Emphasis ours.)

U. S. Code Congressional Service 1944. Page 617.

As stipulated in paragraphs 5 and 6 of the Stipulation the following provisions of the regulations promulgated under the authority of the Emergency Price Control Act of 1942 govern the maximum price the defendant was entitled to charge for the beer involved in this case:

“(a) *For manufacturers and wholesalers.* The maximum price which a manufacturer or wholesaler may charge for a domestic malt beverage, except in 32-ounce containers, shall be the highest price charged by him for such domestic malt beverage during the period October 1 to 15, 1941, inclusive, plus the ‘permitted increase’ set forth in the schedule of permitted increases in paragraph (c) (1) of this section, or the maximum price now established by such manufacturer or wholesaler

under the pricing provisions of the General Maximum Price Regulation, plus the 'permitted increase' for excise taxes only as specified in paragraph (c) (2) of this section."

Section 1420.66 Appendix A(a) Maximum Price Regulation, issued November 2, 1942;

and Section 1499.3(a), the specific provision under which defendant was obligated to price the beer, as agreed by paragraph 6 of the Stipulation states:

"Sec. 1499.3. Maximum prices for commodities which cannot be priced under section 1499.2. The seller's maximum price for a commodity which cannot be priced under section 1499.2 of this General Maximum Price Regulation shall be a maximum price in line with the level of maximum prices established by this General Maximum Price Regulation. Such price shall be determined by the seller in accordance with the following procedures:

"(a) Sales at wholesale or retail. In the case of a sale at wholesale or retail, the seller (1) shall select from the same general classification and price range as the commodity being priced under this section, the comparable commodity for which a maximum price is established under section 1499.2 of this General Maximum Price Regulation and of which the seller delivered the largest number of units during March 1942; (2) shall divide his maximum price for that commodity by his replacement cost of that commodity; and (3) shall multiply the percentage so obtained by *the cost to him of the commodity being priced under this paragraph*. The resulting figure shall be the maximum

price of the commodity being priced. Within ten days after determining such maximum price under this paragraph, the seller shall report such price to the appropriate field office of Price Administration upon a form, duly filled out and signed under oath or affirmation, copied from the form contained in section 1499.24, Appendix A, of this General Maximum Price Regulation. The price so reported shall be subject to adjustment at any time by the Office of Price Administration. (Emphasis ours.)

U. S. Code Congressional Service 1942. Page 377; 7 Federal Register 3135.

FREIGHT PAID ON RETURNED EMPTIES

Was the freight which defendant was compelled to pay on empties returned to the breweries an item of cost to him of the beer to be priced within the meaning of Section 1499.3(a) General Maximum Price Regulation?

The only proper guides for determining this query are the provisions of the quoted regulations. The question would seem to answer itself. It must be admitted that the beer could not have been purchased unless defendant, as the buyer, would pay such freight costs of returned empties. It is further true that never theretofore had the defendant in the conduct of his business assumed and absorbed the cost of return freight on empties. This regulation uses the words "the cost to him" without any qualifying language. The interpretation which the defendant gave the last

quoted section is not only sound but it was also the method approved by the regional office of the Office of Price Administration as late as September 14, 1944. Exhibit "A" of the Stipulation (Tr. 19) shows that defendant had an official ruling as late as September 14, 1944, which stated that the unit replacement cost of beer could include "freight on the return of empty bottles to the brewery." Defendant was told on September 14, 1944, that the correct method of pricing the beer was as follows:

- "1. The comparable commodity you are using is, I believe, ABC Beer. Take your maximum price under OPA regulations for that beer.
- "2. Divide this price by the net unit replacement cost of ABC Beer.
- "3. Multiply the percentage so obtained by your net unit cost of Capitol Beer or the beer being priced. This unit replacement cost may include the cost of Capitol Beer at the brewery, the loading charge at the brewery, freight on full cases and *freight on the return of the empty bottles to the brewery.*" (Emphasis ours.)

and he was further told that such letter could be considered an official interpretation. (Tr. 20.) See Exhibit "A" of the Stipulation.

This ruling was made several weeks after the last sale which plaintiff claims exceeded the selling price, because paragraph 4 of the Stipulation shows that the sales which are now questioned were all made on or prior to August 26, 1944.

We, therefore, have the unusual situation where the Administrator of the Office of Price Administration is seeking to penalize the defendant for doing what the local and regional offices of the OPA and the attorneys for OPA held to be a proper and legal practice at the time the beer was priced and the sales made by defendant.

It is further true that the later adverse ruling from Washington, referred to in Exhibit "B" of the Stipulation, is not stated to be based upon any provision of law, published rule or regulation, but merely asserts what some individual in Washington thought to be more in harmony with the aim of price control than the method adopted by defendant.

It is also noteworthy that *following* the letter of September 29, 1944, Exhibit "B" of the Stipulation, the Office of Price Administration promulgated a specific regulation permitting the inclusion of charges for the return of cases and empty containers under situations such as those existing in the instant case.

"(p) Transportation charges. . . .

"The term 'transportation charges' shall also include charges for the return of cases and empty containers, only where the seller imposed such a charge on a particular class of purchaser during the applicable base period *or where the seller did not ship outside his local area during the applicable base period and now establishes* a maximum price to a new class of purchaser located outside his local area. Such charges shall be at the rate

charged by the cheapest available common or contract carrier customarily used for movement of the cases and containers from the above mentioned purchaser's customary receiving point to the seller's shipping point from which the malt beverage was originally shipped." (Emphasis ours.)

Paragraph (p) of Section 1.2 Amendment 3, Maximum Price Regulation No. 259.

It seems strange indeed that those charged with the enforcement of price control should be urging this Court to impose a further penalty upon the defendant in this action for doing what they themselves thought to be the proper practice until the receipt of contrary advice from Washington in September, 1944. This is the more unusual because of the fact that one has to torture the language of the published regulations to hold that the words "cost to him" contained in the section governing the price of beer did not include the cost of return freight, when, as in this case, the payment of such return freight was a prerequisite to the purchase of the beer being priced.

The unreasonableness of plaintiff's contention is further disclosed when it is borne in mind that the amount involved in this item of return freight, which the plaintiff is seeking to recover from the defendant, was paid out by the defendant to the carriers and the inclusion of such items in the price of the beer did not result in a profit to the defendant.

The failure to properly clarify the regulations, if there was any ambiguity in such regulations, which

point defendant disputes, was the fault of the Office of Price Administration, and if it promulgated and published a regulation which was so vague and uncertain that it was misinterpreted by the regional and local administrators and attorneys, there is no legal basis for the recovery of damages against the defendant, who adopted the same interpretation given the regulation as the local and regional administrators.

The defendant asserts the facts to be that nowhere did any law or published regulation say that return freight under the circumstances in this case was not a proper item of cost to defendant. We cannot find any published regulation or rule which holds that it was improper during the period up to August 25, 1944, to include return freight in computing the maximum price under the General Maximum Price Regulation. Indeed the only evidence we have found that anyone contended that such charges were improper are contained in the letter, Exhibit "B" of the Stipulation, and the claim made by the filing of this action. We do know that the return freight was an actual item of cost to defendant and that the Office of Price Administration has been told by Congress that none of its regulations or orders should "contain any provision requiring the determination of costs otherwise than in accordance with established accounting methods."

It would seem that the bureaucrat who ruled return freight an improper item of cost in cases such as presented here was unfamiliar with established accounting methods and sought to interpret the regulation to suit

his theories of price control rather than in accordance with reason and the wording of the regulation. Undoubtedly the injustice of such interpretation resulted in the adoption of the specific provision which now permits allowance for return freight.

We think there is no just basis, even under a strict interpretation of the law and regulations for denying defendant's right to return freight on empty cases and containers as an item of cost to him.

COMMISSIONS PAID TO BROKERS

Was defendant entitled, under Section 1499.3(a) General Maximum Price Regulation, to include as an item of cost to him brokerage fees which he had to pay to purchase certain beer?

As previously stated, defendant, during 1944, purchased certain stocks of beer through the medium of brokers and such brokers charged defendant fifteen cents per case as a brokerage or finder's fee.

Plaintiff is seeking to recover from defendant something in excess of \$4,000, based upon his contention that defendant had no right to charge such brokerage fee as an item of cost in computing his maximum selling-price under General Maximum Price Regulation for the beer so purchased.

Counsel for defendant are unable to determine the exact basis for this contention because they have been unable to find any regulation or order in effect between

December, 1943, and August 26, 1944, prohibiting the inclusion of such item.

It would appear that OPA takes the position that notwithstanding its published regulations and the meaning ordinarily conveyed by such regulation, it has the right to place the interpretation upon its regulations which it deems best suited to effect the control of prices and that such interpretations, like the regulations, should have the force and effect of law.

We differ basically with this holding. Any such view, we believe, has no support in law. The Price Stabilization Act of 1942 and the regulations and orders promulgated under the act do not attempt to prohibit things which are "*malum in se.*" The prohibitions which the administrator may enforce under the law cover acts which are not immoral or iniquitous in themselves. Certainly the prohibitions set up by the OPA can extend no further than the reasonable intentment of the language used in its published regulations. The defendant should not be penalized because of the stabilization theories held by some of those charged with the administration of the law. If we are to be ruled by executive decrees, certainly the minimum protection which the public can expect is that the decrees be definite and certain and not susceptible to one interpretation by the official holding one set of economic theories and subject to some different interpretation if any particular administrator thinks some other procedure will best effect the purposes of price control.

In short, despite OPA the merchant may still operate as traders have always operated unless the contemplated transaction is expressly prohibited. Applying such test to the inclusion of brokerage as an item of cost to the defendant we can find no regulation or order which prohibits its inclusion.

What was defendant's guiding principle? Maximum Price Regulation No. 259 said he was to price the beer under the rule laid down in Section 1499.3(a) of General Maximum Price Regulation. Paragraph 6 of the Stipulation shows that there can be no question on this score. Nowhere in Section 1499.3(a) nor in the General Maximum Price Regulation was there any prohibition against the inclusion of brokerage, and assuredly under any theory of accounting or business practice it was a proper item of cost.

By Section 5.3 of the General Maximum Price Regulation No. 259, dated December 18, 1944, the payment of brokerage was thereafter expressly prohibited, in the following language:

“Sec. 5.3. Payment of brokerage. Every broker shall be considered the agent of the seller, and not the agent of the purchaser. In each instance, the amount paid by the purchaser to the seller, plus any amount paid by the purchaser to the broker, shall not exceed the seller's maximum price including allowable charges actually paid by the seller or by the broker. In other words, the seller may not collect from the purchaser any more than the maximum price including allowable charges, less any amount the purchaser pays the broker.

“Note: Attention is directed to Revised Maximum Price Regulation 165 establishing maximum prices brokers may charge for their services.”

However, this order was issued some months after the last sale involved in this action.

If, as plaintiff contends, the payment of brokerage was prohibited prior to the adoption of Section 5.3 of General Maximum Price Regulation No. 259, this last section would seem to have been wholly unnecessary. The facts are, however, that there was no specific prohibition against the payment of brokerage prior to December 18, 1944, although some administrative official of OPA may have interpreted the regulation to mean that the payment of brokerage in cases of this kind was contrary to the policy of the act. Any such ruling, however, was never brought to the attention of this defendant and was never published in form so as to charge defendant with notice of the ruling or to give it the force and effect of law.

That the inclusion of brokerage fees was not improper prior to December 18, 1944, the date of Revised Maximum Price Regulation No. 259, is shown, it seems to us, by the following language contained in “Statement of the Considerations Involved in the Issuance of Revised Maximum Price Regulation 259,” which says:

“The new regulation contains provisions designed to prevent use of brokers to shift to purchasers selling expenses which the seller’s maximum price is designed to cover.”

If the payment of brokerage had been prohibited by any existing regulation it is obvious this language would not have been used in the statement of considerations for the issuance of the regulation prohibiting the payment of brokerage.

We repeat that it is not sufficient for some administrative official to determine that a departure from ordinary business principles will further price stabilization. To prohibit any practice which was legitimate prior to price control it is essential that a regulation specifically prohibiting the action be legally adopted and published in the Federal Register.

We do not argue this principal at length or cite authority because this Court has heretofore held such adoption and publication to be a prerequisite to the validity of such an executive order.

Here again the plaintiff is not seeking to strip defendant of a profit which resulted to him from the alleged overcharge (because no profit resulted), but on the contrary is seeking to take away from defendant an amount which defendant has paid to the brokers.

We wish to stress the further point that since neither the wishes and desires of the officials of OPA, nor any purported interpretation of their own rulings can bind defendant unless such orders have been incorporated in a legally adopted regulation published in the Federal Register. Neither should any subsequent interpretation or contention made by OPA officials of their own regulations have any persuasive

effect with the Court in determining this case, but the Court should interpret any pertinent regulation by the same aids which were afforded the defendant, to wit: the meaning ordinarily conveyed by the language of the regulations. Certainly if the language of the regulations was susceptible of an interpretation under which the charges made by defendant were permissible, then defendant is not to be penalized because of another possible interpretation of the regulation. Nor is there any rule of law, which under such circumstances, says the defendant was obligated to adopt the most unfavorable interpretation under peril that he might be held liable for an overcharge if some official of OPA ruled the unfavorable interpretation more consistent with the overall purpose of the act.

APPELLANT'S BRIEF

In these portions of appellee's brief it is the intention to answer certain portions of appellant's brief covering matters not previously argued herein.

(1) On page 11 of appellant's brief appellant makes reference to Section 5.9(b)(1) concerning "Evasions." It is apparent that this provision relates to evasions only and leaves unanswered the question of what items could properly be included in defendant's maximum price. Obviously, if defendant based his charges, as permitted by Section 1499.5 of General Maximum Price Regulation, 7 F. R. 3153, there was no evasion. The appellee submits that this provision

relates only to evasions resulting from changing established maximum prices and does not purport to relate to the method of fixing the price in the first instance. Assume, for the sake of illustration, that a wholesaler selling beer in 1942 then bought beer at a price per case laid down at his warehouse and paid no separate charge for incoming freight. Admittedly under such a state of fact the wholesaler could not charge, after the inception of the act and regulations, a greater price than the price which he had theretofore charged for the beer so delivered to and sold by him. But if, after inception of the act, he desired to buy and did buy beer from some other brewer, which beer was billed to him f. o. b. the brewery, under plaintiff's contention such wholesaler, in establishing his maximum price under Section 1499.3 for beer first handled after the act, would not be entitled to add such incoming freight as an item of his cost because he had not paid a separate charge for freight prior to the act. The contention that such incoming freight was not a part of the "cost to him of the commodity being priced under this paragraph" would be just as logical as the plaintiff's contention in the instant case, because the wholesaler would have paid no separate transportation charges upon his comparable commodity prior to the enactment of the act. Certainly the words "cost to him of the commodity being priced under this paragraph" (1499.3 GMPR), mean just what they say and are to be interpreted under established accounting methods.

(2) On pages 16 through 25 the appellant makes a vigorous attack upon the reasons given by the trial court for its decision. The gist of this attack is that the trial court was without evidence to support its conclusions of law. On this point appellee submits that the following points should be considered:

(a) In the absence of specifications of error the appellate court cannot consider the sufficiency of evidence to support findings of fact.

Gartner v. Hays, et al., 272 Fed. 896.

The appellant cannot, under the well-recognized rule of appeal and error, specify that the court erred in concluding certain matters as a matter of law and then argue the court erred in making certain findings of fact. Obviously the argument of appellant that "defendant adduced no proof whatever" and "this record will be searched from end to end in vain for any semblance of any proof," must be disregarded by this court as being argument upon points not raised in this appeal.

(b) The parties in their stipulation stated that as to the amounts claimed by defendant as legitimate costs "the plaintiff has made no allowance for return freight to the brewery on empty cases and bottles or brokerage commissions or finder's fees *paid by said defendant.*" (Tr. 13.) The only reasonable inference from this stipulation is that the defendant did actually pay these costs.

In *Clyde Equipment Company vs. Fronto*, 16 Fed. (2nd) 106 (C. C. A. 9th) it was held that if a finding

of fact is susceptible of two constructions, one of which supports the judgment and the other does not, the former will prevail and whenever from the facts found other facts may be inferred which will support the judgment such inferences will be deemed to have been drawn.

Certainly, if this is true of findings of fact made upon a trial of a case, it must be equally true of findings of fact made upon stipulation. Appellee submits that the only reasonable inference to be raised is the inference which supports the court's judgment below, namely, that the defendant did pay these charges.

3. Appellant, on page 17 of its brief, refers to a presumption that a condition which has been shown to exist, has continued. Upon this presumption appellants asks that this Court should assume that the new supplier absorbed ordinary freight charges and brokerage commissions as the former supplier had previously absorbed such charges. It is obvious this presumption would not operate since new conditions had intervened. New suppliers were selling to the defendant and new price structures had intervened.

However, if appellant is reduced to the point of quoting "presumptions," appellee counters with a presumption of much greater validity, that is, the presumption that the law is being obeyed. It has been specifically held by federal courts that it cannot be assumed, merely because the contrary has not been established by proof, that an individual or a corporation has conducted its affairs in violation of law.

Railroad v. Rankin, 241 U. S. 319, 36 S. Ct. 555, 60 L. Ed. 1022;

Railway Express v. Lindenburg, 260 U. S. 584, 43 S. Ct. 206, 67 L. Ed. 414;

Railway v. Stewart, 245 U. S. 362, 62 L. Ed. 347, 38 S. Ct. 130;

Kirby v. U. S., 273 Fed. 391 (C. C. A. 9th);

Packing Company v. Steamship Company, 22 Fed. (2nd) 12 (C. C. A. 9th).

Appellee therefore submits that the trial court merely rendered judgment based upon the presumption that defendant's supplier was making legitimate charges for the merchandise furnished to the defendant. No proof was necessary upon this point and no inference arises from lack of such proof that the charges were illegal or unauthorized by the OPA.

4. Finally it is submitted that the appellant cannot in good faith question the stipulation, which was the result of uncoerced exercise of discretion by both parties in the trial court. The parties expressly stipulated, in paragraphs 11, 12 and 13, that judgment in a certain sum should be rendered under certain circumstances. Certainly this court cannot now order that a different judgment should be entered because the court below did not make findings of fact which were not within the terms of the stipulation.

There is a serious question whether an appeal lies from a case which has been submitted by the parties on stipulation.

“The principal established is that, when the parties have agreed that a certain judgment shall be rendered for either of them, according to the opinion of the judges, on a case stated, the Court of Errors cannot rescind that agreement and enter a different judgment. It is the same in principle as if they had agreed that judgment should be entered according to the opinion of any other individuals; or that it should depend on any other collateral event. When the opinion is given, or the other event happens, and the judgment is entered accordingly, it is so entered by the consent and agreement of the parties, in like manner as if they had in any other mode ascertained what was right and just between them, and had afterwards come into court and consented to a judgment accordingly.”

Wellington v. Stratton, 11 Mass. 394, 395, 3 C. J. 610.

A case supporting this view is *Pickney v. Railroad*, 109 Atl. 700 (Cert. den.) 245 U. S. 631, 65 L. Ed. 447, 41 S. Ct. 7. It appears, however, that *U. S. v. Eliason*, 16 Peters 291, 10 L. Ed. 968, has probably settled this question in favor of the appellant here. Nevertheless, it is submitted that the stipulation below must be construed most strictly in favor of the defendant. It is submitted that appellant cannot be heard to say that the stipulation did not contain facts or reasonable inferences therefrom sufficient to support the judgment of the court below.

CONCLUSION

It is respectfully submitted that the decision of the trial court was correct and should be affirmed.

KNAPP, BOYLE, BILBY & THOMPSON,
B. G. THOMPSON,
ARTHUR HENDERSON,

907 Valley National Building,
Tucson, Arizona,

Attorneys for Appellee.

Appendix

APPENDIX

“Sec. 1499.3. Maximum prices for commodities which cannot be priced under section 1499.2. The seller’s maximum price for a commodity which cannot be priced under section 1499.2 of this General Maximum Price Regulation shall be a maximum price in line with the level of maximum prices established by this General Maximum Price Regulation. Such price shall be determined by the seller in accordance with the following procedures:

“(a) Sales at wholesale or retail. In the case of a sale at wholesale or retail, the seller (1) shall select from the same general classification and price range as the commodity being priced under this section, the comparable commodity for which a maximum price is established under section 1499.2 of this General Maximum Price Regulation and of which the seller delivered the largest number of units during March 1942; (2) shall divide his maximum price for that commodity by his replacement cost of that commodity; and (3) shall multiply the percentage so obtained by *the cost to him of the commodity being priced under this paragraph*. The resulting figure shall be the maximum price of the commodity being priced. Within ten days after determining such maximum price under this paragraph, the seller shall report such price to the appropriate field office of Price Administration upon a form, duly filled out and

signed under oath or affirmation, copied from the form contained in section 1499.24, Appendix A, of this General Maximum Price Regulation. The price so reported shall be subject to adjustment at any time by the Office of Price Administration.” (Emphasis ours.)

7 F. R. 3153.

No. 11417

United States
Circuit Court of Appeals
For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

NATIONAL RESERVE INSURANCE
COMPANY,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court
of the United States

FILED

NOV 8 1918

PAUL P. O'BRIEN,
CLERK

No. 11417

United States
Circuit Court of Appeals
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	PAGE
Answer	19
Appearances	1
Certificate of Clerk	128
Designation of Portions of Record, Proceedings and Evidence to be Contained in the Record on Review	126
Docket Entries	1
Findings of Fact, Opinion and Dissenting Opinion	20
Notice of Filing Petition for Review	44, 45
Petitioner's Designation of the Portion of the Record to be Printed	122
Petition	4
Petition for Review	40
Proceedings	83
Statement by Amos A. Betts	119
Statement of Evidence	7
Statement of Points	46
Statement of the Case on Behalf of the Com- missioner	52

Statement of the Case on Behalf of the Taxpayer	49
Witnesses for the Taxpayer:	
Wahl, William	
—direct	54
—cross	62
—redirect	79, 81
—recross	80
Petitioner's Exhibits:	
No. 1. Extracts from Life Insurance Policies	91
No. 2. Articles of Incorporation of National Reserve Insurance Company	93
No. 3. By-Laws of the National Reserve Insurance Company	98
No. 5. Arizona Corporation Commission General Order No. 160-I	104
No. 6. Arizona Corporation Commission General Order No. 165-I	106
Respondent's Exhibits:	
A. Comparative Balance Sheet	107
C. Analysis of Mortality Fund	109
D. Mortuary Fund	110
E. Analysis of Mortality Fund	111

APPEARANCES

For Taxpayer:

Z. SIMPSON COX, Esq.,

E. C. CROUTER, Esq.,

For Comm'r:

Docket No. 112638

NATIONAL RESERVE INSURANCE COM-
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1942

Oct. 1—Petition received and filed. Taxpayer notified. Fee paid.

Oct. 1—Copy of petition served on General Counsel.

Oct. 13—Notice of appearance of Z. Simpson Cox as counsel for taxpayer filed.

Nov. 4—Answer filed by General Counsel.

Nov. 4—Request for hearing in Los Angeles, Calif., filed by General Counsel.

Nov. 7—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1943

- Aug. 10—Hearing set September 20, 1943—Los Angeles, California.
- Aug. 17—Motion to place on the Reserve calendar, filed by General Counsel.
- Aug. 19—Hearing set September 8, 1943 on motion.
- Aug. 30—Petitioner's joiner respondent's motion to place on Reserve calendar, filed.
- Sep. 1—Respondent's Motion of Aug. 17 granted to Reserve A.
- Sep. 5—Motion to place proceeding on Los Angeles, Calif. calendar filed by General Counsel. 9/7/44 Granted.
- Oct. 14—Hearing set November 27, 1944—Los Angeles, California.
- Nov. 27—Hearing had before Judge Arnold on & 28 merits. Briefs due 1/13/45, Replies 2/2/45. Statement of Amos A. Betts received in evidence with same force and effect as a deposition, filed at hearing.
- Dec. 21—Transcript of hearing 11/27/44 and 11/28/44 filed.

1945

- Jan. 11—Motion for extension to 1/31/45 to file opening briefs and 2/24/45 to file reply briefs, filed by General Counsel. 1/11/45 Granted.
- Jan. 30—Brief filed by General Counsel.
- Feb. 15—Motion for extension to 3/24/45 to file brief, filed by taxpayer. 2/16/45 Granted.

Mar. 23—Brief filed by taxpayer. Copy served.

Apr. 16—Reply brief filed by taxpayer. 4/16/45
Copy served.

1946

Mar. 14—Findings of fact and opinion rendered.
Judge Arnold. Decision will be entered
for petitioner. 3/15/46 Copy served.

Mar. 15—Decision entered. Judge Arnold. Div. 12.

Jun. 3—Petition for review by U. S. Circuit Court
of Appeals, 9th Circuit, with assignments
of error filed by General Counsel.

Jun. 18—Proof of service of petition for review
filed. (2) Counsel for taxpayer and tax-
payer.

Jul. 16—Certified copy of an order from the 9th
Circuit for extension to 8/12/46 to pre-
pare and transmit the record, filed.

Aug. 2—Statement of points filed by General
Counsel with statement of service thereon.

Aug. 2—Statement of evidence filed, with state-
ment of service by mail thereon.

Aug. 2—Designation of portions of the record to
be printed, filed by General Counsel, with
statement of service by mail thereon.

Aug. 2—Designation of portions of record, pro-
ceedings and evidence to be contained in
the record on review, filed by General
Counsel.

Aug. 6—Copy of an order from 9th Circuit ex-
tending time to 9/12/46 to prepare and
transmit the record filed.

United States Board of Tax Appeals

Docket No. 112638

NATIONAL RESERVE INSURANCE COM-
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

Comes Now the above named petitioner and hereby petitions for a redetermination of the deficiency set forth by the Commisisoner of Internal Revenue in his notice of deficiency, LA:IT:90D:PB, dated July 7, 1942, and as a basis for its proceeding alleges as follows:

1. Petitioner is and was at all times herein mentioned an Arizona corporation duly qualified and doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937, (Art. 6, Chapt. 53, Arizona Code Annotated 1939), with principal office at 214 Phoenix National Bank Building, Phoenix, Arizona. The returns for the periods here involved were filed with the Collector for the District of Arizona. [3*]

2. The determination of the Commissioner of Internal Revenue of petitioner's tax liability for the taxable years 1939 and 1940 and notice thereof,

* Page numbering appearing at top of page of original certified Transcript of Record.

a copy of which is attached hereto marked "Exhibit A", and by reference made a part hereof, was mailed to petitioner July 7, 1942.

3. The taxes in controversy are income taxes for the calendar years 1939 and 1940 in the amounts of \$1,087.59 and \$734.53, respectively.

4. The determination of the tax set forth in said notice of deficiency is based upon the following errors (no complaint being made as to any mathematical calculation):

(a) The Commissioner has determined: "It is determined that no part of your reserve funds is held for the fulfillment of life insurance contracts within the meaning of Section 201, Internal Revenue Code, and that you are subject to tax under the provisions of Section 207, Internal Revenue Code." Whereas, under the undisputed evidence before the Commissioner, and the law applicable thereunto, more than fifty per centum of petitioner's total reserve funds were held for the fulfillment of life insurance contracts within the meaning and intent of Section 201, Internal Revenue Code. [4]

(b) The Commissioner has failed to determine petitioner's income taxes for the years 1939 and 1940 under Sections 201, 202, and 203, Internal Revenue Code, but has erroneously determined same under section 207, Internal Revenue Code.

(c) The Commissioner has determined that the additions made to mortuary reserve during the taxable years 1939 and 1940 do not constitute addi-

tions required by law to be made within the respective years to reserve funds within the meaning of Section 207, Internal Revenue Code.

(d) The Commissioner has determined that the additions made to mortuary reserve during the taxable years 1939 and 1940 are not proper deductions in the computation of petitioner's taxable income under Section 207, Internal Revenue Code.

(e) The Commissioner has determined that the additions made by the petitioner to funds on deposit with the State of Arizona during the taxable years 1939 and 1940 do not constitute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code.

(f) The Commissioner has determined that the additions made by petitioner to funds on deposit with the State of [5] Arizona during the taxable years 1939 and 1940 are not proper deductions in the computation of petitioner's taxable income under Section 207, Internal Revenue Code.

(g) The Commissioner has determined that petitioner is not an assessment insurance company within the purview of Section 207(c) (1) (A), Internal Revenue Code.

(h) The Commissioner has determined that the sums actually deposited with State Treasurer of the State of Arizona by petitioner in accordance with laws of the State of Arizona (Sec. 53-605 Arizona Code Annotated 1939) were not the net addi-

tions required by law to be made within the respective taxable years to reserve funds as provided in Section 207(c) (1) (A), Internal Revenue Code.

(i) The Commissioner has determined that the sums actually deposited by petitioner as an assessment insurance company with the State Treasurer of the State of Arizona pursuant to the law of the State of Arizona (Section 53-605 Arizona Code Annotated 1939 is not allowable as a deduction under section 207(c) (1) (A), Internal Revenue Code.

(j) The Commissioner has determined that petitioner's mortuary reserve funds as required by the laws of the State of Arizona (Section 53-606 and 53-609, Arizona [6] Code Annotated 1939 are not required by law within the meaning of Section 207 (c) (1) (A), Internal Revenue Code.

(k) The Commissioner has determined that petitioner's mortuary reserve funds (being premium deposits retained by petitioner for the payment of losses are not allowable as a deduction under Section 207(c) (3), Internal Revenue Code.

(l) The Commission has failed to properly classify petitioner under the Internal Revenue Code.

(m) The Commissioner has failed to properly determine petitioner's gross income under the Internal Revenue Code.

(n) The Commissioner has failed to allow petitioner deductions allowable under the Internal Revenue Code.

5. The facts upon which petitioner relies as a basis of this proceeding are as follows:

(a) The petitioner is and was at all times herein mentioned an insurance company engaged in the business of issuing life insurance contracts including contracts of combined life and accident insurance, and not engaged in any other business whatsoever, and the reserve funds of petitioner held for the fulfillment of such contracts have at all times herein mentioned comprised more than 50 per centum of its total reserve funds for all purposes. [7]

(b) The petitioner is a life insurance company as defined by and within the meaning of Section 201(a) Internal Revenue Code.

(c) The petitioner is not a mutual insurance company as defined by and within the meaning of Section 207 of the Internal Revenue Code.

(d) The Articles of Incorporation, By-laws and insurance contracts of petitioner require the setting aside of definite sums in a Mortuary Reserve Fund and its maintenance for the payment of claims arising under certificates of membership or policies issued upon the assessment plan, and in accordance with said Articles of Incorporation, By-laws and insurance contracts, petitioner set aside in said mortuary and reserve fund the net sum of \$6,557.65 in 1939 and \$4,762.98 in 1940.

(e) The mortuary reserve funds of petitioner are also required by the laws of the State of Arizona (Sections 53-606 and 53-609, Arizona Code Annotated 1939).

(f) The Corporation Commission (Insurance Department) of the State of Arizona by virtue of law also requires and makes mandatory the creation and maintenance of petitioner's mortuary reserve funds. [8]

(g) Petitioner deposited with the State Treasurer of the State of Arizona \$789.47 in 1940, under the provisions of the laws of the State of Arizona (Section 53-605, Arizona Code Annotated 1939), as additions to guarantee or reserve funds.

(h) The mortuary reserve funds of petitioner have been created from premium income of petitioner and from no other source.

(i) Petitioner's deposits with the State of Arizona have been created from premium income of petitioner and from no other source.

6. In the event this Honorable Board should determine that petitioner is taxable under Section 207, Internal Revenue Code, and only in that event, and without waiving petitioner's contention that it is a life insurance company taxable under Section 201, et seq., the further facts upon which petitioner also relies as a further basis for the proceeding are as follows:

(a) Petitioner is an assessment insurance company within the meaning of said Section 207(c) (1) (A), Internal Revenue Code.

(b) Petitioner has made actual deposits of the sum of \$789.47 in the calendar year 1940 with the State Treasurer of the State of Arizona under the

provisions of the law of the State of Arizona, (Section 53-605, Arizona Code Annotated, 1939) as additions to [9] guarantee or reserve funds.

(c) All additions to petitioner's mortuary reserve funds during the calendar years 1939 and 1940 were required by law to be made during each respective year to said reserve fund within the purview and meaning of Section 207(c) (1) (A), Internal Revenue Code.

(d) Petitioner required its members to make premium deposits to provide for losses and expenses.

(e) All amount retained by petitioner during the calendar years 1939 and 1940 were portions of premium deposits retained for the payment of losses or expenses.

(f) The increase in petitioner's deposits to the State of Arizona during the calendar year 1940 were portions of premium deposits by petitioner's members retained for the payment of losses or expenses.

(g) The increases in petitioner's mortuary reserve during the taxable years 1939 and 1940 were portions of premium deposits by petitioner's members retained for the payment of losses or expenses.

Wherefore, Petitioner Prays That This Board May Hear The Proceeding And Determine:

1. That petitioner is a life insurance company

as defined by and within the meaning of Section 201, Internal Revenue Code. [10]

2. That the mortuary reserve of petitioner is required by law as defined by and within the meaning of Section 202, Internal Revenue Code.

3. That the additions to deposits with the State Treasurer of the State of Arizona by petitioner are required by law as defined by and within the meaning of Section 202, Internal Revenue Code.

4. That from the gross income of petitioner as defined by Section 202, Internal Revenue Code, petitioner is entitled to allowable deductions as set forth in said section.

Petitioner Further Prays: That in the event this Honorable Board should determine that petitioner is not taxable under Section 201, Internal Revenue Code, but under Section 207 thereof, and only in that event, this Board will further determine:

1. That additions to petitioner's mortuary reserve in the calendar years 1939 and 1940 are allowable deductions from petitioner's gross income under section 207(c) (1) (A), Internal Revenue Code.

2. That additions to petitioner's deposits with the State Treasurer of the State of Arizona in the calendar year 1940 are allowable deductions from petitioner's gross income under Section 207(c) (1) (A), Internal Revenue Code.

3. That the amount of premium deposits re-

tained by petitioner in its mortuary reserve during the calendar years 1939 and 1940 is an allowable deduction from petitioner's gross [11] income under Section 207(c) (3), Internal Revenue Code.

4. That the amount of premium deposits retained by petitioner during the calendar years 1939 and 1940 for the payment of losses and expenses is an allowable deduction from petitioner's gross income under Section 207(c) (3), Internal Revenue Code.

Petitioner Further Prays: For such other and further relief as may be meet, just and proper in the premises, and your petitioner will ever pray.

Respectfully submitted,

NATIONAL RESERVE IN-
SURANCE COMPANY,

By /s/ KENNETH K. POUND

Secretary-Treasurer.

Counsel:

J. Simpson Cox. [12]

State of Arizona,

County of Maricopa—ss.

Kenneth K. Pound, being by me first duly sworn, deposes and says:

That he is the Secretary-Treasurer of the National Reserve Insurance Company, a corporation, the petitioner in the foregoing petition, and that he is duly authorized to verify the foregoing petition and to make this affidavit thereto;

That he has read the foregoing petition and knows the contents thereof and that the same are true to the best of his knowledge, information and belief.

/s/ KENNETH K. POUND

Subscribed and sworn to before me this 29 day of September, 1942, at Phoenix, Maricopa County, Arizona.

[Seal] /s/ W. H. CHESTER

Notary Public.

My commission expires: Aug. 12, 1945. [13]

EXHIBIT "A"

Treasury Department
Internal Revenue Service

12th Floor
U. S. Post Office and Court House
Los Angeles, California.

July 7, 1942

Office of Internal Revenue Agent in Charge Los Angeles Division LA:IT:90D:PB.

National Reserve Insurance Company,
214 Phoenix National Bank Building,
Phoenix, Arizona.

Sirs:

You are advised that the determination of your income tax liability for the taxable years 1939 and

1940 discloses a deficiency of \$1,822.12 as shown in the statement attached.

In accordance with provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner.

Internal Revenue Agent in
Charge.

Enclosures:

Statement.

Form of Waiver. [14]

STATEMENT

LA:IT:90D:PB

National Reserve Insurance Company,
214 Phoenix National Bank Building,
Phoenix, Arizona.

Tax Liability for the Taxable Years Ended
December 31, 1939
and
December 31, 1940

Income Tax

Year	Liability	Assessed	Deficiency
1939	\$1,087.59	None	\$1,087.59
1940	734.53	None	734.53
	<hr/>	<hr/>	<hr/>
Total	\$1,822.12	None	\$1,822.12

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated April 14, 1942.

It is determined that no part of your reserve funds is held for the fulfillment of life insurance contracts within the meaning of section 201, Internal Revenue Code, and that you are subject to tax under the provisions of Section 207, Internal Revenue Code.

The additions made during the taxable years to mortuary reserve and to funds on deposit with the State of Arizona do not constitute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code, and are therefore not proper deductions in the computation of your taxable income under section 207, Internal Revenue Code.

—2—

National Reserve Insurance Company.

Statement.

ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1939

Net income (loss) as disclosed by return..... (\$ 21.18)

Addition to net income:

Adjustment resulting from the determination
of net income as shown below 6,612.65

Net income adjusted \$6,591.47

EXPLANATION OF ADJUSTMENT

Giving effect to the above holdings with respect to the additions to the mortuary reserve and to funds on deposit with the State of Arizona, your net income for this taxable year has been determined under the provisions of section 207, Internal Revenue Code, as follows:

Income:

Premium Income \$24,395.22

Membership fees 5,453.00

Total income \$29,848.22

Expenses:

Claims paid \$ 3,723.91

Claims expense 104.13

Refunds to members 1,597.93

Salaries 4,463.30

Printing & Stationery 212.00

Office supplies 173.08

Postage 631.36

Rent 645.29

Directors fees 180.00

Bond premiums 27.00

Legal & audit 105.12

Medical fees 32.00

Taxes 41.24

Miscellaneous 128.66

Commissions and fees paid 10,696.56

Reinstatements & hospitalization fund 495.17

Total expenses \$23,256.75

Net income \$ 6,591.47

—3—

National Reserve Insurance Company.

Statement.

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1939

Net income adjusted	\$ 6,591.47
Special class net income	\$ 6,591.47
Income tax:	
16½% of \$6,591.47	\$ 1,087.59
Income tax assessed	None
Deficiency of income tax	\$ 1,087.59

ADJUSTMENT TO NET INCOME

Taxable Year Ended December 31, 1940

Net income (loss) as disclosed by return.....	(\$ 5.80)
Addition to net income:	
Adjustment resulting from the determination of net income as shown below.....	4,952.08
Net income adjusted	\$ 4,946.28

EXPLANATION OF ADJUSTMENTS

Giving effect to the above holdings with respect to the additions to the mortuary reserve and to funds on deposit with the State of Arizona, your net income for this taxable year has been determined under the provisions of section 207, Internal Revenue Code, as follows:

Income:	
Premium income	\$30,238.41
Membership fees	11,690.44
Reinstatement fees	477.60
Other income	206.92
Less: Payments refunded	(37.58)
Total income	\$42,575.79

—4—

National Reserve Insurance Company.

Statement.

Expenses:

Claims paid	\$ 5,256.20
Claims expense	436.45
Refunds to members	4,154.18
Salaries	5,617.50
Printing & stationery	500.69
Office Supplies	194.35
Postage	856.80
Rent	640.79
Directors fees	175.00
Bond premiums	27.00
Legal & audit	25.00
Medical fees	43.00
Taxes	57.05
Miscellaneous	161.26
Commissions and fees paid	19,242.68
Reinstatement & hospitalization fund	241.56
<hr/>	
Total expenses	\$37,629.51
Net income	\$ 4,946.28

COMPUTATION OF INCOME TAX

Taxable Year Ended December 31, 1940

Net income adjusted	\$ 4,946.28
Normal-tax net income	4,946.28
Income tax:	
13½% of \$4,946.28	\$667.75
Defense tax (10% of \$667.75)	66.78
<hr/>	
	\$ 734.53
Income tax assessed:	None
<hr/>	
Deficiency of income tax	\$ 734.53

[Endorsed]: U. S. Board of Tax Appeals. Filed Oct. 1, 1942.

The Tax Court of the United States

Docket No. 112638

NATIONAL RESERVE INSURANCE COM-
PANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar years 1939 and 1940, but denies the remainder of paragraph 3 of the petition.

4 (a) to (n), inclusive. Denies the allegations of error contained in subdivisions (a) to (n), inclusive, of paragraph 4 of the petition.

5 (a) to (i), inclusive. Denies the allegations contained in subdivisions (a) to (i), inclusive, of paragraph 5 of the petition.

6 (a) to (g), inclusive. Denies the allegations

contained in subdivisions (a) to (g), inclusive, of paragraph 6 of the petition. [19]

7. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA O. BAIRD

Division Counsel.

FRANK T. HORNER,

SAMUEL TAYLOR,

Special Attorneys,

Bureau of Internal Revenue.

st-ppw 10-30-42

[Endorsed]: T.C.U.S. Received and filed Nov. 4, 1942. [20]

[Title of Tax Court and Cause.]

6 T. C. No. 61

Promulgated March 14, 1946.

FINDINGS OF FACT, OPINION AND
DISSENTING OPINION

During 1939 and 1940 petitioner was engaged in writing life insurance contracts. Its mortality or

reserve fund for the protection of its policyholders was maintained in compliance with its by-laws and insurance contracts and exceeded the reserves required by Arizona law. Petitioner erroneously charged on its books certain minor expense items to its mortality fund during each of the taxable years. It charged refunds to policyholders and expenses incident to settlement of policy claims against the mortality fund as authorized by Arizona law. None of the charges so made impaired the reserves required by state law. Held: petitioner is a life insurance company within the meaning of section 201 (a) I.R.C., as the reserve funds held for the purpose of fulfilling its life insurance contracts were in excess of 50 percent of its total reserve funds.

Z. SIMPSON COX, Esq.,
for the petitioner.

EARL C. CROUTER, Esq.,
for the respondent. [21]

The Commissioner determined deficiencies in income taxes for 1939 and 1940 in the respective amounts of \$1,087.59 and \$734.53. He held that no part of petitioner's reserve funds was held for the fulfillment of life insurance contracts within the meaning of section 201, Internal Revenue Code, and that petitioner was subject to tax under section 207 of the Code. In computing petitioner's tax liability under section 207 he held that additions to petitioner's "mortuary reserve and to funds on deposit with the State of Arizona do not consti-

tute additions required by law to be made within the respective taxable years to reserve funds within the meaning of section 207, Internal Revenue Code, and are, therefore not proper deductions in the computation of your taxable income under section 207, Internal Revenue Code.” Petitioner challenges these determinations by respondent.

FINDINGS OF FACT

Petitioner is an Arizona corporation doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937, Art. 6, Chap. 53, Arizona Code Annotated, 1939. Its principal office is at Phoenix, Arizona. Its tax returns for 1939 and 1940 were filed with the collector for the district of Arizona.

For 1939 petitioner reported on its income and excess profits tax return total income of \$14,296.25, deductions of \$14,317.43, and a net loss of \$21.18. The return stated that petitioner was engaged in the “Assessment Insurance” business and that it was a non-stock, non-profit, mutual corporation. For 1940 petitioner reported total income of \$22,909.82, deductions of \$22,915.62, and a net loss of \$5.80. This return stated that it was engaged in the life insurance business and was a non-stock, non-profit, mutual corporation. [22]

During the taxable years petitioner issued only two types of life insurance policies, known as the “Individual or Group Life Policy” and the “Whole Life Insurance Policy.” The Individual or Group

Life Policies provided with respect to the "Reserve or Mortality Fund" that—"After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto." The Whole Life Insurance Policies carried the same provisions with respect to the Reserve or Mortality Fund except that after the first month 50% of the first year's premium and 66-2/3% of all subsequent payments were to be placed in the reserve or mortality fund. All life insurance policies issued prior to the taxable years carried the same provision as the Whole Life Insurance Policy except one which specifically incorporated the provisions of petitioner's by-laws into the certificate or policy.

Petitioner's by-law with respect to the reserve or mortality fund provided as follows:

Article XVI.

Funds

Section 1. The Death Benefit Fund of this Association shall be created, maintained and shall consist of Fifty per cent (50%) of the first year's assessment, less the first month's payment; and sixty-six and two-thirds per cent (66-2/3%) of all subsequent payments except where a certificate shall lapse and reinstatement shall be dispersed in the same manner as the first year's assessment following the date of issuance of the certificate. The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of

Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings. [23]

Section 2. The expense fund of this Association shall be created, maintained and shall consist of only, the membership and registration fees, the first month's payment of assessment and the first month's payment of any reinstatement, and fifty per cent (50%) of the following eleven months' payments and thirty-three and one-third per cent ($33\frac{1}{3}\%$) of all subsequent payments.

The Arizona Benefit Corporation Law of 1937 required that every benefit certificate issued by any such corporation shall specify the maximum amount not exceeding \$5,000, on the life of any individual, to be paid on the happening of the contingency therein stated, and "shall state the basis or amount to be set aside to the mortuary and reserve fund." Arizona Code, 1939, sec. 53-606. Every benefit corporation was required to provide in its benefit certificate for periodical payments or dues sufficient "to pay benefit claims and general operating expenses as stipulated therein." Sec. 53-609 (a), and sub-paragraph (b) of said section provided as follows:

(b) A mortuary and reserve fund, exclusive of

other assets, may be created, out of which may be paid all benefit claims arising under the certificates, the deposits required to be made with the state treasurer as provided by section 608b, and attorney's fees and necessary expense arising out of the defense, settlement, or payment of any contested or disputed claim. The residue of payments made by members, after setting aside the amount required for the mortuary and reserve fund, and interest earned by the assets of the corporation, whether deposited with the state treasurer or otherwise invested, may be used for general operating expenses.

Section 53-610 provided that the state Corporation Commission should require the examination and audit of the books and affairs of each benefit corporation at least once in every two years by an accountant designated and commissioned by it for the purpose of verifying the funds as provided in the benefit certificate. The cost of any such examination and audit was to be paid by the benefit corporation but it was not required to pay for more than one examination and audit in any one year, and not to exceed \$25 for each 1,000 certificates or fraction thereof in force at the time of the examination. Section 53-611 required the benefit [24] corporation to file a copy of its certificate with the Corporation Commission before soliciting business thereon and the Commission was required within three days to issue a certificate of authority to transact business thereon if the certificate con-

formed to the requirements of the Benefit Corporation law.

The Corporation Commission submitted the copy filed with it pursuant to sec. 53-611 to its actuary to ascertain whether the provisions thereof met all the requirements of law and its rules and regulations, with respect to the reserve fund set up for the protection of policyholders. Except for the first year the Commission required any new insurance policy to provide for the placing of not less than 50 percent of the premiums in a reserve fund, which amount was deemed sufficient to enable the reserve fund to meet all the requirements of the American Standard Mortality Table on the basis of $3\frac{1}{2}$ percent interest accretions. Each year since 1937 petitioner has been examined by and has met the requirements of the Arizona Corporation Commission.

Petitioner's mortality fund for the taxable years shows the following allocations to and disbursements from the fund:

MORTUARY FUND

Balance in Reserve January		
1, 1939		\$8,095.46
Gross Amount allocated to		
Fund, Year 1939	11,960.08	
Paid out for Death Claims 3,828.04		
Paid out Refunds to Policy-		
holders	1,597.93	5,425.97
	<hr/>	<hr/>
Balance of 1939 allocation un-		
expended		6,564.11
		<hr/>

Total Reserve Fund		
December 31st		14,659.57
Gross Amount allocated to		
Fund, 1940	14,514.16	
Paid out for Claims	5,437.60	
Paid out Refunds to Policy-		
holders	4,154.18	9,591.78
	<hr/>	<hr/>
Balance 1940 allocation un-		
expended	4,922.38	
Less allocation to fund		
on hospitalization in		
error, based on State		
Examination, January		
14, 1941	241.56	4,680.82
	<hr/>	<hr/>
Total Reserve Fund December		
31, 1940		\$19,340.39

The cash and other assets held in reserve for claim purposes as of the end of 1939 and 1940 consisted of cash on hand or in bank \$8,257.75 and \$11,248.26, respectively, deposit with state treasurer \$2,000 and \$2,789.47, respectively, secured loans of \$337.16 and \$349.92, respectively, and government bonds of \$5,015.58 for each year. Petitioner's actual assets held in reserve for claim purposes exceeded the total reserve fund shown at the end of the taxable years in its mortality fund.

Petitioner's general ledger carried an account entitled, "Income - Premium Renewals - Mortality Fund." Petitioner charged this account with payments on policy claims, expenses incidental thereto, refunds to policy holders, and certain minor items hereinafter considered. The petitioner was required by the state Corporation Commission to make

refunds to policy holders under the provisions of by-law XVI relating to the savings in its Death Benefit or Mortality Funds. Such Refunds, shown as "Paid out Refunds to Policyholders" in the preceding table, were reflected in its general ledger account as "dividends". Petitioner's mortality fund or reserve after refunding the savings to policyholders was in excess of the reserve required by the Commission to protect policyholders. The expenses incidental to payment of policy claims included telephone, telegraph and hospital bills, medical, notary and attorney fees, and traveling expenses, all of which charges were tied in with specific policy claims settled by the petitioner. The expenses incidental to settling a policy claim were not excessive nor were the aggregate incidental expenses excessive for either of the taxable years. The minor items charged to the account aggregated \$34.99 in 1939 and \$47.03 in 1940. These minor disbursements were not identified with any specific claim and were erroneously charged on petitioner's books against its mortality fund. For 1939 these minor items were: "State audit", \$25.00; telegram, 32 cents; check book, \$1.00; bank service charge, \$2.10; N. S. F. ck., \$1.32; correction, \$5.25. For 1940 these minor items were: "State audit", \$25.00; N. G. check, \$4.13; bank service charges, \$2.79. \$7.48 and \$7.63. Petitioner credited the account with the total monthly receipts allocated to the mortality fund and balanced the account monthly.

Except for \$206.92 received in 1940 as income from invested funds, petitioner's income during the

taxable years was derived entirely from premiums. Each premium payment was allocated daily to the mortality fund and the expense fund in accordance with the terms of the life insurance contract.

During the taxable years petitioner maintained the reserves required by the laws of Arizona and its policy contracts. More than 50 percent of its total reserve funds were held for the fulfillment of its life insurance contracts, and petitioner is entitled to classification as a life insurance company within the meaning of section 201, Internal Revenue Code, and applicable Treasury regulations.

OPINION

Arnold, Judge: The question of whether a corporation operating under the Arizona Benefit Corporation Laws of 1937 is entitled to classification as a life insurance company for Federal income tax purposes was considered by this Court in *Reliance Benefit Association, a Corporation*, 2 T. C. 15, petition to review dismissed, June 13, 1944, 143 Fed. (2d) 597. We there construed sections 201 (a) of the Revenue Acts of 1936 and 1938, the provisions of which are identical with the provisions of section 201 (a), Internal Revenue Code, set forth in the margin,¹ and held the taxpayer was a life insurance company as defined by the Federal revenue statutes.

¹Sec. 201. Tax on Life Insurance Companies.

(a) Definition.—When used in this chapter the term life insurance company means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts

Petitioner relies upon our decision in the cited case, and contends that the evidence adduced establishes its right to be similarly treated. It is conceded that there is a deficiency if the reserves maintained by petitioner are not reserves "required by law", and if petitioner falls under section 207, I.R.C., which relates to mutual insurance companies other than life.

The taxing statute defines a life insurance company as an insurance company engaged in issuing life insurance, the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds. The facts show that petitioner was engaged during the taxable years in issuing life insurance policies. Its "total reserve funds" within the meaning of section 201 (a) *supra*, must, therefore, relate to reserves set up in connection with its life insurance business.

To be entitled to classification as a life insurance company under section 201 (a) the evidence must show that petitioner's reserves held for the fulfillment of its life insurance contracts comprised more than 50 per centum of its total reserve funds. The facts show that the Arizona law and the Commission charged with the enforcement of the law, whose rules and regulations had the force and effect of the law,² and under which petitioner operated, required

of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

²Reliance Benefit Association, *supra*, pp. 16-17.

petitioner to place 50 percent of its premium receipts, after the first year, in a reserve fund which, with interest accretions at $3\frac{1}{2}$ percent, was deemed sufficient under recognized mortality tables to protect policyholders.

All policy forms issued by petitioner during the taxable years were examined by the state commission and were approved as meeting state legal requirements for the protection of policyholders. Our findings show that petitioner allocated daily to its mortality reserve fund $66\frac{2}{3}$ percent of its premium receipts, after the first year, as required by the provisions of its life insurance policies. The facts show that each year since 1937 petitioner has been examined by the Arizona Corporation Commission and found to meet state requirements relative to the maintenance of reserves. It is clear that without compliance with state requirements petitioner would have been forced to cease doing business. *Pioneer Mutual Benefit Association v. Corporation Commission*, 123 Pac. (2d) 828.

In the transaction of its life insurance business petitioner maintained only two funds, namely, its mortality fund and its expense fund. The mortality fund was the reserve fund held by petitioner for the fulfillment of its life insurance contracts. The expense fund was used to meet the general operating expenses of the business and certainly was not a reserve within the meaning of that term as defined by the Supreme Court in *Maryland Casualty Company v. United States*, 251 U. S. 342, 350, which

definition is the basis for the definition appearing in the Treasury's regulations.

Respondent introduced as an exhibit petitioner's general ledger account for the taxable years for the purpose of showing that certain items charged against the mortality fund were not strictly benefit claims. The largest such items charged to this account during the taxable years were refunds to policyholders or dividends. Such disbursements were in no proper sense a part [29] of petitioner's operating costs or expenses. They recorded the pro rata refund to petitioner's policyholders of excess premiums. Petitioner was a non-stock, non-profit, mutual corporation and the savings or excess premiums in its mortality fund belonged to its policyholders. Its mortality reserve was not impaired by the pro rata distributions to policy holders. At all times material hereto this reserve was in excess of legal requirements. The incidental expenses charged to the mortality reserve were properly charged thereto under state law and petitioner's by-law XVI. The ledger entries with respect to incidental expenses specifically referred to the policyholder whose claim was being settled and the expense items charged to the fund were incidental to settlement of the claims payable under the policies. The aggregate amount in each year was not excessive and did not impair the reserve fund required by law to protect its policyholders. The minor items were frankly admitted by petitioner to be an improper charge against the mortality fund. It is urged, however, that these items were nominal in

amount, and did not affect the sufficiency of petitioner's reserve, and show that the ledger account was not kept in accordance with good bookkeeping practices.

Respondent argues strenuously that because of these charges the reserve funds held by petitioner were not true reserves as defined by section 201 (a), since the reserve fund was subject to and was actually used to meet general operating expenses as well as policy claims. Respondent cites and relies upon *First National Benefit Society v. Stuart*, (CCA-9, 1943) 134 Fed. (2d) 438, 30 AFTR 1151, certiorari denied, 320 U. S. 211; *First National Benefit Society v. Stuart*, (D.C. 1944) unreported case, decided June 15, 1944, 444 CCH 19440, and section [30] 19.203 (a) (2)-1 of Treasury Regulations 103.³ We do not understand that respondent

³Sec. 19.203 (a) (2)—1. Reserve Funds.—In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or

denies the sufficiency in amount of petitioner's mortality reserve; his point is that regardless of the amount set aside in the fund it was not a reserve since it could be and was invaded for ordinary operating expenses, and if a part of the fund is subject to such use the entire fund could be so used, which prevents the fund from being a "reserve fund" within the meaning of section 201 (a) *supra*.

In considering respondent's argument it must be remembered that general operating expenses were payable out of the expense fund provided for by section 2, Art. XVI of petitioner's by-laws. His argument poses the question of whether the payment of minor items, which in no way impaired the reserve funds required for the protection of policyholders, and which were erroneously charged thereto, makes that reserve fund other than a reserve for benefit claims. We think not. To so hold would give book entries a probative weight to which such entries are not entitled, *Doyle v. Michell Bros. Co.* 247 U. S. 179, 3 AFTR 2979. Petitioner's assets available to satisfy policy claims and the mortality reserve exceeded [31] mortality reserve requirements. Bookkeeping errors or the use of this excess for business purposes should not defeat petitioner's

net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

classification as a life insurance company where it otherwise meets the requirements of section 201.

Respondent argues that we should construe the term "reserve funds" in section 201 (a) the same as the Treasury Regulations construe that term in section 203 (a) (2) of the Code. In *Reliance Benefit Association, supra*, we assumed that the term "reserve funds" was to be given the same meaning in both sections. On that point, among other things, we said: "The validity of such regulations (referring to the regulations on this point) has been recognized by this and other courts, *Swift and Co. Employees Benefit Association*, 47 B. T. A. 1011 and cases cited therein * * *."

But while agreeing with the Commissioner in the *Reliance Benefit Association* case, *supra*, that the term "reserve funds" meant the same in both sections of the statute, we did not agree with him that the reserves there involved did not meet the test of the statute. We held that "reserve funds" in that case, which were arrived at in all essential respects in the same way as in the instant case, qualified as true life insurance reserves within the purview of section 201 (a), and that the taxpayer there was taxable as a life insurance company. We so hold here. [32]

The *First National Benefit Society* cases cited by respondent, *supra*, are factually distinguishable. The Circuit Court decision dealt with the Arizona laws prior to the 1937 revision and amendments. The court there agreed with the lower court's find-

ing that the First National Benefit Society did not voluntarily keep, and no statute, rules, or regulations of the state or governing body required the Society to keep, a reserve fund for the fulfillment of its life insurance contracts. Here, the Arizona law as interpreted by its Supreme Court in Pioneer Mutual Benefit Association, *supra*, not only required the creation of the reserve fund but delegated to the Arizona Corporation Commission the power and duty to require that the reserve so established shall be sufficient to pay benefit claims under the policies. Reliance Benefit Association, *supra*, pp. 16 and 17. The District Court decision in the First National Benefit Society case, *supra*, decided June 15, 1944, dealt with 1938 taxes and affirmed Articles 201 (a)-1 and 203 (a)-1 of Treasury Regulations 101 in their interpretation of section 201 (a) of the Revenue Act of 1938. The District Court read into the term "reserve funds" in section 201 (a), the same meaning given the term in section 203 (Art. 203 (a)-1, Reg. 101) by concluding as a matter of law that the Society did not have or maintain a "reserve fund" for the sole purpose of fulfilling its insurance contracts. Since the filing of briefs herein the Circuit Court of Appeals for the Ninth Circuit has affirmed the District Court in *First National Benefit Society v. Stuart*, Fed. (2d), (December 11, 1945) not upon the above ground, but upon the ground that petitioner had failed to sustain its burden of proof, i. e., that it was a life insurance company within the meaning of section 201. We can find no such

failure of proof in the instant case, which also differs in other [33] material respects from the District Court case.

As hereinbefore indicated we are of the opinion that this petitioner was required to and did maintain reserves for the fulfillment of its life insurance contracts. These reserves were in excess of 50 percent of petitioner's total reserve funds. Except for certain minor charges against the mortality reserve, which did not change the character of that reserve, our facts are comparable to the facts in *Reliance Benefit Association*, *supra*. Since the petitioner wrote only life insurance contracts and since its reserves held to fulfill such contract obligations were in excess of 50 percent of its total reserve funds, we hold that petitioner is a life insurance company within the meaning of section 201 of the Code, and that there is no deficiency for either of the taxable years.

Reviewed by the Court.

Decision will be entered for the petitioner. [34]

Disney, J., dissenting:

The reserve in question in this case must be one "held for the fulfillment of" life insurance and annuity contracts. As I read the record in this matter, the reserve can not be said to be so here. The prime object of life insurance, I take it, is the safety of the policy holders. Therefore, reserves "for the fulfillment of such contracts" are required by section 201 (a). In my view, considering the object of life insurance to be as above seen,

the reserve must be one exclusively held for the fulfillment of the life insurance contracts. I think the word "exclusively," although not expressed in the text of the Act, is, because of the nature of the legislation, a reasonable interpretation. The mortuary fund here, however, was held not solely for the fulfillment of the insurance policies, but for the paying of premium refunds, attorney's fees, for the setting up of a legal reserve life insurance company, and for other expenses. Moreover, on the matter of premium refunds, it appears that any excessive premiums were returnable from the mortuary fund—although only 25 per cent or 50 per cent of the premiums of the first year of a policy, and 66-2/3 per cent of the premiums in later years, went into the reserve, thus subjecting the reserve to a drain of a greater amount than ever went into it. As to attorney's fees, not only was there no limit to the cost of litigation which might be taken from the fund under this item, but the expenses of attorney's fees to contest insurance policies appears to me to be the antithesis of the "fulfillment of such contracts"—for which reserve funds must be held. I am altogether unable to [35] comprehend how a mortuary fund, subject to be drawn upon to set up a legal reserve life insurance company can be said to be held for the fulfillment of the insurance contracts.

In my opinion, therefore, the mortuary fund here involved was held also for the payment of premium refunds, attorney' fees, and formation of a legal reserve life insurance company, and therefore not

“for the fulfillment” of life insurance and annuity contracts. I would not say that mere mistaken charges against the mortuary fund, due to error, would violate the statute, but any withdrawals except by such error, indicate that the fund was held for the purposes of such withdrawals, and not merely for the fulfillment of life insurance policies.

The present question was not discussed or decided in *Reliance Benefit Association, a Corporation*, 2 T. C. 15, so that if it in fact lurked in the record in that case, the opinion is not authority here. It involved only the manner of computing a reserve, and not whether it could be drawn upon for various and sundry matters aside from fulfillment of the contracts and still be within section 201 (a). I therefore dissent.

Hill, J., agrees with this dissent.

[Seal] T. C. V. S. [36]

[Title of Tax Court and Cause.]

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 14, 1946, it is

Ordered and Decided: That there are no deficiencies in income tax for the years 1939 and 1940.

[Seal] /s/ WILLIAM W. ARNOLD,
Judge.

[Entered]: V. S. T. C. March 15, 1946. [27]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B.T.A. Docket No. 112638

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

NATIONAL RESERVE INSURANCE COM-
PANY,

Respondent on Review.

PETITION FOR REVIEW

The Commissioner of Internal Revenue, hereinafter referred to as the Commissioner, holding his office by virtue of the laws of the United States, hereby petitions the United States Circuit Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on March 15, 1946, ordering and deciding that there are no deficiencies in income tax due from the National Reserve Insurance Company for the calendar years 1939 and 1940. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

National Reserve Insurance Company, the respondent on review, hereinafter referred to as the taxpayer, is an Arizona corporation duly qualified and doing business under and by virtue of the provisions of the Arizona Benefit Corporation Laws of 1937 (Art. 6, Chap. 53, Arizona Code Annotated,

1939), and filed its corporation income, declared value excess-profits, and defense tax returns (Form 1120) for the years 1939 and 1940 with the Collector of Internal Revenue for the District of Arizona at Phoenix, Arizona, whose office is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit, wherein this review is sought. [38]

NATURE OF CONTROVERSY

The nature of the controversy is as follows:

During the years 1939 and 1940, the taxpayer, an insurance company, was engaged in issuing policies known as the "Individual or Group Life Policy" and the "Whole Life Insurance Policy" in the State of Arizona. The Arizona Benefit Corporation Law of 1937 required that every benefit certificate issued by any such corporation shall specify the maximum amount, not exceeding \$5,000, on the life of any individual to be paid on the happening of the contingency therein stated, and "shall state the basis or amount to be set aside to the mortuary and reserve fund." The individual or group life policies provided with respect to the "Reserve or Mortality Fund" that "After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto." The whole life insurance policies carried the same provisions with respect to the reserve or mortality fund, except that after the first month 50% of the first year's premium and

66-2/3% of all subsequent payments were to be placed in the reserve or mortality fund. Except for the first year, the Arizona State Corporation Commission required any new insurance policy to provide for placing of not less than 50% of the premiums in a reserve fund, which amount was deemed sufficient to enable the reserve fund to meet all requirements of the American Standard Mortality Table on the basis of 31½% interest accretions.

In its returns for the years 1939 and 1940, taxpayer claimed, by reason of its maintenance of the reserve funds for the purpose of [39] paying the benefits provided for in its insurance contracts, that it was entitled to be classified as a life insurance company for Federal tax purposes under Section 201 of the Internal Revenue Code, and should be allowed to deduct the additions to its reserve funds maintained under the laws of Arizona and its policy contracts in computing its income tax liability for each of said years.

Upon audit of the returns for the years 1939 and 1940, the Commissioner determined that the additions made by the taxpayer to its reserve funds during the years 1939 and 1940 were not proper deductions in the computation of taxable income for said years for the reason that no part of said reserve funds was held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code, and issued his 90-day notice under date of July 7, 1942, setting forth deficiencies in income tax for the years 1939

and 1940 in the amounts of \$1,087.59 and \$734.53, respectively.

Under date of October 1, 1942, taxpayer petitioned the United States Board of Tax Appeals (now The Tax Court of the United States) for a re-determination of the deficiencies asserted for the years 1939 and 1940, alleging, among other things, that the Commissioner had erred (1) in determining that no part of its reserve funds was held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code and that it should be taxed under Section 207 of the Internal Revenue Code, (2) that the additions made to its mortuary reserve funds during the taxable years 1939 and 1940 do not constitute additions to reserve funds required by law within the [40] meaning of section 207 of the Internal Revenue Code, and therefore are not proper deductions in the computation of its taxable income under said sections of the Internal Revenue Code, and (3) that the additions made during the years 1939 and 1940 to funds on deposit with the State of Arizona, pursuant to the Arizona Benefit Law of 1937, were not proper deductions in the computation of its income under Section 207 of the Internal Revenue Code. All material allegations were denied in Commissioner's answer filed November 4, 1942.

Since taxpayer's reserve funds maintained in compliance with its by-laws and insurance contracts exceeded the reserves required by the Arizona Benefit Corporation Laws for the fulfillment of its

insurance contracts comprise more than 50% of the total reserve funds, the Tax Court held in its opinion promulgated March 14, 1946, 6 T. C.—(No. 61), that it was a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Code.

Under date of March 15, 1946, the Tax Court entered its decision, wherein it ordered and decided that there are no deficiencies in income tax for the calendar years 1939 and 1940.

/s/ DOUGLAS W. MCGREGOR,
Assistant Attorney General.

CAR

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue Counsel for Petitioner on Review.

JWS:RRZ 5-9-46

[Endorsed]: T.C.U.S. Received and Filed June 3, 1946. [41]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: Z. Simpson Cox, Esquire
406 Phoenix National Bank Building
Phoenix, Arizona

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of June, 1946, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition

for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 3rd day of June, 1946.

/s/ J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue, Counsel for Petitioner on Review.

Personal service of the foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 6th day of June, 1946.

/s/ Z. SIMPSON COX,

Counsel for Respondent on Review.

PWS:RRZ 5-9-46

[Endorsed]: T. C. U. S. Received and Filed June 18, 1946. [42]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To: National Reserve Insurance Company
214 Phoenix National Bank Building
Phoenix, Arizona

You are hereby notified that the Commissioner of Internal Revenue did, on the 3rd day of June, 1946, file with the Clerk of The Tax Court of the

United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 3rd day of June, 1946.

/s/ J. P. WENCHEL, CAR
Chief Counsel, Bureau of Internal Revenue, Coun-
sel for Petitioner on Review.

Personal service of the foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 6th day of June, 1946.

NATIONAL RESERVE INSUR-
ANCE COMPANY,

By /s/ KENNETH K. POUND,
Sec. and Treas.

JWS:RRZ 5-9-46

[Endorsed]: T. C. U. S. Received and Filed
June 18, 1946. [43]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS

Now comes the Commissioner of Internal Revenue, the petitioner on review herein, by his attorneys, Douglas W. McGregor, Assistant Attorney General, and J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and hereby asserts the fol-

lowing errors on which he intends to rely in this review:

That the Tax Court of the United States erred:

1. In holding and deciding that the taxpayer was a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Code and Sections 19.201 (a)-1 and 19,203(a)(2)-1 of Treasury Regulations 103.

2. In holding and deciding that the reserve funds held during the years 1939 and 1940 for the purpose of fulfilling its life insurance contracts were in excess of 50% of its total reserve funds.

3. In failing to hold and decide that the additions made by taxpayer to its reserve funds during the years 1939 and 1940 were not proper deductions in the computation of taxable income for said years, because no part of said reserve funds was exclusively held for the fulfillment of life insurance contracts within the meaning of Section 201(a) of the Internal Revenue Code. [44]

4. In entering its decision wherein it ordered and decided that there are no deficiencies in income tax for the years 1939 and 1940.

5. In failing and refusing to enter a decision redetermining deficiencies of \$1,087.59 and \$734.53 for the years 1939 and 1940, respectively.

6. In that its decision is not supported by the evidence.

7. In that its decision is contrary to law and regulations.

/s/ DOUGLAS W. MCGREGOR,
Assistant Attorney General.

/s/ J. P. WENCHEL, CAR
Chief Counsel, Bureau of Internal Revenue, Counsel
for Petitioner on Review.

Statement of Service:

A copy of Statement of Points was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Building, Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,
Special Attorney
Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T. C. U. S. Received and Filed
Aug. 2, 1946. [45]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF EVIDENCE

This proceeding came on for hearing before the Honorable William W. Arnold, Judge of The Tax Court of the United States, at Los Angeles, California, on November 27, 1944. Z. Simpson Cox, Esquire, appeared on behalf of the taxpayer and the Commissioner of Internal Revenue by his counsel, Earl C. Crouter, Esquire.

The proceeding was heard on oral testimony and documentary evidence. All of the testimony introduced which is material and necessary for the determination by this Court of the assignments of error set out by the Commissioner in his statement of points is set forth herein in narrative form.

STATEMENT OF THE CASE ON BEHALF OF THE TAXPAYER

By Mr. Cox: First of all, I would like to proceed as far as we can except for the testimony of Mr. Betts, and we would ask the Court if it will hold the case open for the purpose of taking the deposition of Mr. Betts, if necessary. He is in the White Memorial Hospital, Los Angeles, California, having been taken there for a broken collar bone [46] which he received during last night on his ride from Phoenix to Los Angeles.

Mr. Crouter: Could he testify in the latter part, say, of this week or next week, whenever he is available?

Mr. Cox: Possibly so. I haven't been able to talk to the doctor.

The Court: How long do you judge his testimony would take?

Mr. Cox: I would judge approximately 15 minutes.

The Court: We can arrange to get that in some time later, if that is satisfactory?

Mr. Crouter: That is agreeable.

The Court: You may state the nature of the

case and what you expect to cover by your testimony.

Mr. Cox: This case involves income taxes for the years 1939 and 1940. The taxpayer was incorporated in 1934 under and by virtue of the laws then in existence in the State of Arizona, under the name of Franklin Mutual Benefit Association, which was later changed to Family Group Union, and then on April 22, 1928 to National Reserve Insurance Company, which it now is.

The taxpayer has done business during all of the times herein involved under Chapter 36 of the 1937 Session Laws of Arizona, which was incorporated in the present Arizona Code, Annotated, 1939, as Article 6, Chapter 53, and became effective on June 12, 1937, and that same law was in effect during the years 1939 and 1940. At all times necessary for the determination of this case, taxpayer was engaged in business under this Statute and in no other business whatsoever. The statute is known as the Benefit Corporation Law of 1937. [47]

The taxpayer was in the business of issuing policies of life insurance and combined life and accident insurance. All policies, except some that were initially issued in 1936, provided for a reserve or mortuary fund, variously entitled as reserve, or mortuary fund, or death benefit fund, or a reserve fund for the purpose of paying claims under the policies; and the by-laws of the corporation also required setting aside a percentage of the premium income into this reserve fund. The policies all made the by-laws a part of the policy. All of the policies,

except the one mentioned, provided for 66-2/3 per cent of the premium income after the first year, and the first policy mentioned was handled in the same manner, in accordance with the by-laws incorporated in the policy during the years in controversy. During the first year, after the first month's premium, most of the policies provided for 50 per cent of the ensuing eleven monthly premium payments to be paid into this same reserve fund.

In 1940 a new policy was issued, which provided for 26 per cent after the initial month for the next ensuing eleven months, and all of them provided for the 66-2/3 per cent thereafter.

Under the Benefit Corporation Law of 1937, the taxpayer has at all times involved in this controversy been under the jurisdiction of the Arizona Corporation Commission, which is constitutionally, and by that statute, particularly, charged with the regulation of the taxpayer. At all times after the effective date of the Act, June 12, 1937, the Commission has refused to approve or authorize the use by taxpayer of any form of policy that did not provide that after the first year from date of issuance at least 50 per cent of all premium payments be credited and placed in the mortuary and reserve fund contemplated by the Benefit [48] Corporation Law of 1937. The funds were created and maintained by taxpayer in accordance with the provisions of the policies, the regulations of the Corporation Commission, and the by-laws, which were a part of the policy, and by reason of the Benefit

Corporation Law of 1937. Under that law, it also was required that taxpayer make deposits to the State Treasurer of the State of Arizona. During the year 1939, taxpayer deposited with the State Treasurer the sum of \$166.70, and for 1940 the sum of \$789.47. Taxpayer's deposits into its mortuary and reserve fund will also be shown by the evidence. Taxpayer had no other income than premium income during the years 1939 and 1940. Taxpayer's entire income was from premium income, except for the sum of \$206.92.

The Court: What is the question at issue in this case?

Mr. Cox: The first question is, is taxpayer a life insurance company as defined by Sections 201 and 202 of the Internal Revenue Code, or if not, is taxpayer taxable under Section 207. The second question relates to the deduction allowable under Section 207.

STATEMENT OF THE CASE ON BEHALF OF THE COMMISSIONER

By Mr. Crouter: In this case the Commissioner determined, as stated in the deficiency notice, that no part of the reserve funds of the taxpayer is held for the fulfillment of life insurance contracts within the meaning of Section 201 of the Internal Revenue Code, and that taxpayer is subject to tax under the provisions of Section 207 of the Internal Revenue Code. Also, that the additions made during the taxable years to mortuary reserve and to funds on deposit with the State of Arizona do not con-

stitute additions required by law to be made within the respective taxable years [49] to reserve funds, within the meaning of Section 207 of the Code, and are, therefore, not proper deductions within the meaning of taxable income under Section 207.

The Court will probably recall that a number of matters with respect to life insurance classification are left by the statute to be controlled by the regulations, and the regulations have been consistent, as have several Revenue Act, with respect to exactly what constitutes a mortuary fund,—a mortuary reserve, which is set aside and definitely maintained for the payment of death claims, and nothing else, and they have definitely provided that such a fund shall not be available and cannot be made available for ordinary running expenses.

It is the Commissioner's position that, so far as we have been able to ascertain and so far as we know now, this company did not maintain the required mortuary reserve in order to be entitled to classification under Section 201(a) of the Revenue Act of 1938 and the Internal Revenue Code. That is chiefly because of the nature of that mortuary reserve, but also on account of the procedure there, which is somewhat uncertain in my mind, as to the State requirement. I am doubtful whether a true reserve, in the sense of the revenue requirement, was even required, as a matter of fact, by the State Insurance Commissioner. Whether it was required as a matter of printed regulations or State statute, I am not prepared to state.

The Court: Very well. You may call your first witness.

WILLIAM WAHL

was called as a witness for and on behalf of the taxpayer, and having been first duly sworn, was examined and testified as follows: [50]

Direct Examination

By Mr. Cox:

The Witness: My name is William Wahl. During the years 1939 and 1940 I was employed by the National Reserve Insurance Company, keeping its books during that time. During said years there were deposited with the State Treasurer of the State of Arizona \$167.67 and \$789.47, respectively. During the year 1939 the total premium income for mortuary purposes was \$11,990.08, and for operating or expense fund purposes \$17,858.15. That was the total income for those two purposes during the year 1939. For the year 1940 the total income for mortuary purposes was \$14,514.16, and for expense purposes \$28,061.63. These amounts were derived entirely from premiums. There was no interest income during the year 1939. During the year 1940 \$206.92 was received from interest on invested funds.

During the year 1939 the net amount deposited to the mortuary reserve fund was \$6,564.11, and for 1940 it was \$4,680.82.

Q. Did this figure include the amount deposited with the State of Arizona?

A. It did not.

Q. As premiums were received in the office, were

(Testimony of William Wahl.)

you familiar with the breakdown on those premiums? A. Yes, sir.

Q. First let's take the first month's premiums on policies. What about those?

A. That was allocated 100 per cent to the expense fund. [51]

Q. And not from a bookkeeping standpoint, but actually what happened with that money?

A. Well, that was primarily commissions paid and was retained by agents in the field.

Q. Is the same true on membership fees shown——

A. That is correct.

Q. ——on the deficiency statement?

A. That's right.

Q. Now, as to membership fees, how was that set up on the books, Mr. Wahl?

A. We just made an arbitrary entry from the standpoint of income, setting up a per policy amount, as set up in the policy, allowable in the policy for membership fees, and then we made a journal entry to just offset it in total, because that money did not come into the office. We were not in a position to account for it, because it was the practice of agents in the field—some of them collected it, others did not, and we were unable to determine just how much of that money was actually collected by the agents, so that we could pick it up as income, and at the suggestion of the Department over there, we just made an arbitrary entry of that, and it was accepted by the State

(Testimony of William Wahl.)

Auditors on every audit that they made of our books. So that was just an in-and-out item, and did not represent actual receipts by the company.

Q. After the first month's premium, a portion of the premium on most of the policies was allocated to the mortuary reserve fund. Now was that handled? [52]

A. As the money was received, we set up what we called a daily receipts spread, and on that spread we indicated the policy number, the name of the policy holder, and made our allocation to the two funds out of each item, in accordance with the contracts involved, and we carried that total through to the end of the month, and then journalled it into our cash receipts journal, and from there to the general ledger. But that split was made of every item, as we received it, every day.

Q. Then those funds for the mortuary reserve were entered separately and kept separately?

A. Absolutely. They were not even entered as income for operations at all.

Q. I notice from the auditor's report during the years 1939 and 1940 there was a deficiency in the expense fund?

A. That is right.

Q. As a result of that, do you know what had to be done there? A. Yes, I do.

Q. What? Will you state what that was?

A. The officers of the company were required to bring that—replace that money so that the difference between the deficit in the expense fund and

(Testimony of William Wahl.)

the requirements in the mortuary fund would not be affected by that deficiency. In other words, they had to bring in acceptable assets, either in the way of cash or bonds, to bring up the deficiency. Otherwise, theoretically they would interpret our mortuary fund as being short whatever we overspent in the expense fund, and they were required by the Department to bring that mortuary fund up to the required limits, as set up in our books. [53]

Q. Were expenses payable from the mortuary fund?

A. None, except for claims.

Q. Of the money deposited with the State Treasurer of the State of Arizona, was any of that withdrawn, in whole or in part, from the depositary during the years 1939 or 1940?

A. If I get your question correctly, the only withdrawal that might be made would be from the standpoint of converting cash on hand with the Department, that is, the Insurance Department, into bonds, or something like that. There was no withdrawal from any deposits made to the State of Arizona.

Q. In other words, the company had some \$1,866.00 and some cents, or some such figure, in cash on deposit, and that was substituted by \$2,000.00 in United States bonds—

A. That is correct.

Q. —during the calendar years 1939 and 1940?

A. Yes.

Q. Do you know whether or not the company

(Testimony of William Wahl.)

did submit all of its policies to the Arizona Corporation Commission for approval?

A. They did. That was a requirement of the Department, of the Arizona Corporation Commission.

Q. Do you know, of your own knowledge, whether or not the Corporation Commission made any requirement as to deposits in the mortuary reserve fund?

A. I do. We wouldn't have been able to operate unless we had it.

Q. The Commission did require it?

A. Absolutely. [54]

Q. Was there a definite requirement as to percentage, and do you recall that?

A. It had to be at least 50 per cent.

Mr. Crouter: Is that pursuant to a written regulation?

The Witness: Yes.

Mr. Cox: I believe—I know it is oral, and I believe there is a written regulation.

The Witness: Yes.

By Mr. Cox:

Q. It is a written regulation?

A. Yes.

Mr. Cox: We offer in evidence as Petitioner's Exhibit 1 the policies of insurance in force during the years 1939 and 1940.

Mr. Crouter: As I understand it, this is just a copy of each representative policy?

Mr. Cox: Each representative policy, yes.

(Testimony of William Wahl.)

Mr. Crouter: And that there were different policies, various policies of these different kinds in force during those two years?

Mr. Cox: May I get you right? There might have been a thousand or two thousand policies written of each kind.

Mr. Crouter: Yes. And these are just blank forms, are they?

Mr. Cox: Yes.

Mr. Crouter: No objection.

The Court: They will be received in evidence as Petitioner's Exhibit No. 1. [55]

(The policy forms referred to were marked and received in evidence as Petitioner's Exhibit No. 1.)

By Mr. Cox:

Q. Did the National Reserve Insurance Company during the years 1939 and 1940 have any other reserve funds other than the mortuary reserve funds you have spoken of?

A. We ordinarily referred to the expense fund as a reserve fund for expenses. That is all, just those two funds, the mortuary fund and the expense fund.

Q. Then from the inception of the company up until or after the year 1940, I believe it was 1941, the expense fund was usually in the red; is that not correct?

A. That is correct.

Q. And was either charged against non-admitted assets or was just out and out in the red?

(Testimony of William Wahl.)

A. That is right.

Q. Were any of these policies which I show you as Petitioner's Exhibit 1, under which reserves were not set apart during the years 1939 and 1940, to the mortuary reserve fund which you testified to?

A. No, each policy here carried a certain required portion to the mortuary fund.

Q. I call your attention to one of the policies wherein there is no provision in the general provisions of the policy for funds, or if there is, I have been unable to find it. That is one of the first policies, I believe, written by the company (handing document to witness)? [56]

A. Well, it refers to the by-laws, and the by-laws specify that there must be a certain amount of money set aside for mortuary purposes.

Mr. Cox: I offer in evidence as Petitioner's Exhibit 2 the articles of incorporation of the company, and ask that a copy be substituted, subject to the examination of counsel for the Respondent in checking it with the originals, which are here available.

Mr. Crouter: Yes. There is no objection on the Respondent's behalf as to the copy going in, under the circumstances stated.

The Court: Very well. It will be received in evidence as Petitioner's Exhibit No. 2.

(The articles of incorporation referred to were marked and received in evidence as Petitioner's Exhibit No. 2.)

Mr. Cox: And we offer as Petitioner's Exhibit

(Testimony of William Wahl.)

No. 3, under the same circumstances, the by-laws of the company.

Mr. Crouter: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 3.

(The by-laws referred to were marked and received in evidence as Petitioner's Exhibit No. 3.)

Mr. Cox: I will state the only change from the originals which I have are the name changes in the articles of incorporation, which is on a separate paper, but it is incorporated directly in the original articles.

By Mr. Cox:

Q. I refer you to Article XVI of the by-laws, and ask you if that is the article of the by-laws to which you referred?

A. That is correct. [57]

Q. And even the one policy which did not provide specifically for funds was handled in that same manner?

A. That is right.

Q. That policy, which was the last policy in the exhibit, was only issued for a short time; is that not correct?

A. That is right.

Q. Then all subsequent policies provided for the mortuary reserve fund?

A. That is correct.

Q. As to the funds in the mortuary fund, they came from premium income alone and no other source; is that correct?

(Testimony of William Wahl.)

A. That is correct.

Mr. Cox: That is all.

Cross Examination

By Mr. Crouter:

Q. Mr. Wahl, do I understand that you were the Petitioner company in 1939 and 1940?

A. That is correct, sir.

Q. Now, referring to Petitioner's Exhibit No. 1 in evidence, without taking the time to go through all these policies, are these all copies or specimens or representative policies of life insurance?

A. Yes, sir.

Q. That were written on the life of some individual?

A. That is correct. These can be either used for an individual, or if there are several individuals in the same family, why, they could be covered, were used to cover a family group. [58]

Q. That is as to beneficiarcies?

A. No, this (indicating) is the name of the insured, and there could be several, several could be insured there.

Q. Oh, you write a group policy in a sense?

A. That is right.

Q. As I understand, all of these various specimens were written during the two years, 1939 and 1940?

A. That is right.

Mr. Crouter: Yes, my question is whether policies of this type were written and these are representative of those policies that were actually exe-

(Testimony of William Wahl.)

cuted between the company and insured persons. As I understand it, these are offered as specimens of policies which were actually executed.

Mr. Cox: I don't want any confusion, Mr. Crouter. The policies are in the order they were printed. This, as you can see by the name on the particular one, is the Family Group Union Association, and then as they became older, it was changed to National Reserve over here. During 1939 these other policies—well, these (indicating) were the only two that were written.

By Mr. Crouter:

Q. Counsel points out to me that the four documents, the last four nearest the bottom here, were policies of a different association. Were they?

A. No, they were the same association, except under these contracts the name had been changed from Family Group Union Association to the National Reserve Insurance Company, but it was the same management, the same set-up exactly.

Q. Well, it was only the National Reserve Insurance Company which [60] issued policies during the two years we have here, wasn't it?

A. I believe that is correct. Those dates would have to be confirmed from the minutes.

Q. That is what we want to find out in this case, exactly what kinds of policies were issued during these two years, 1939 and 1940. I believe you can answer this: Referring to these last four policies in this Exhibit 1, which show that they were issued by Family Group Union Association,

(Testimony of William Wahl.)

were such policies or similar forms outstanding during 1939 and 1940?

A. That's right, yes.

Q. The policies of the type shown by the first three specimens from the top down in this exhibit are of the kind which were issued by National Reserve Insurance Company?

A. That is right.

Q. During the taxable years?

A. That is right.

Q. And policies of that type also were outstanding from the date of issuance?

A. That is correct.

Q. Were policies of that kind issued before 1939?

A. That date—you would have to confirm that date.

Q. Well, the record shows there was a change of name of the corporation in 1936. Is that correct?

Mr. Cox: There was no business done by the National Reserve Insurance Company from the date of its incorporation in 1934 until 1936, at which time its name was changed from Franklin Mutual Benefit to the Family Group Union Association, and on April 22, 1938, the name was changed from Family Group [60] Union Association to National Reserve Insurance Company. But the articles of incorporation and the by-laws and policies all remained identical. It wasn't a new corporation.

Mr. Crouter: Now, referring to the——

(Testimony of William Wahl.)

The Court: That is to be considered in the record, is it?

Mr. Crouter: That is his counsel's explanation. I believe it is helpful. It is not directly material on the issues.

The Court: Very well.

By Mr. Crouter:

Q. Referring to the first paper in Exhibit 1, here, in the provision here, "Reserve or Mortality Fund," that reads:

"After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments will be placed in this fund, for the purpose of payment of claims and expenses incidental thereto."

A. That is correct.

Q. Now, is there a similar provision in these other policies? A. Yes.

Q. The second one apparently is identical, isn't it? A. Yes.

Q. That is paragraph 11 of the second policy from the top down?

A. Reserve or mortuary fund, yes.

Q. The third policy has 50 per cent instead of 25 per cent, does it not? A. Yes.

Q. The third one reads, for the record:

"After the first month (50%) of each payment of the first year's premium and (66-2/3%) of all subsequent payments will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto."

I notice that the form is one which apparently

(Testimony of William Wahl.)

was issued by Family Group Union Association? [61]

A. Yes.

Q. Or is a type issued by them, and also has a similar provision of 50 per cent for the first year and 66-2/3 per cent for subsequent payments?

A. That is right.

Q. Now, by following questions will relate particularly to the monies which were actually paid to the company and handled by the company. Now, first, as to the \$167.67 which you testified about, which was deposited with the State Treasurer, just what was the background of that, and why was that amount deposited?

A. Could I show you this ledger sheet?

Q. Yes, I will be glad to see it. Do I understand this is a ledger of the Petitioner's?

A. This is the original ledger sheet of the Petitioner. When these companies began business under this Arizona Statute, they were required by a certain day to have on deposit with the State of Arizona \$2,000.00 and so this company started—made their first deposit back here in September of 1937. They deposited \$1,000.00. There is the cash journal sheet number, and they came down to the end of—or down to this date in 1938, when we had on deposit in cash with the State of Arizona \$1,833.30.

Q. That is at the end of 1938?

A. That is right.

Q. Now, right there, is that a fund which is

(Testimony of William Wahl.)

tied up with your State Insurance requirements, or does that relate to something else?

A. That is required by the State Insurance requirements.

Q. Do you know what that requirement is? Is that a printed instruction or regulation? [62]

A. That is a printed instruction which said all mutual companies to start must have a certain number of members, and within a given length of time they must have on deposit the sum of \$2,000.00, and that each year thereafter, until they have on deposit with the State \$10,000.00, a given percentage must be deposited, which in some cases was—well, it was one per cent of your revenue each year, had to be deposited with the State of Arizona until the entire fund was \$10,000.00.

Mr. Cox: This is objectionable. This is all a part of the statute. I mean, this is statutory.

Mr. Crouter: But I want to get at the figures, what was actually done.

Mr. Cox: Well, that is one percent.

By Mr. Crouter:

Q. That one percent, did it constitute one percent of all premiums paid, we will say—that one percent?

A. That one percent would be based upon all premiums paid.

Q. So that at the end of 1938 the total amount was \$1,833.30? A. Yes.

Q. Is that the only amount that was on deposit

(Testimony of William Wahl.)

with any branch of the State Government there in connection with insurance business?

A. That is right.

Q. All right. Now, was that same account maintained through 1939 and 1940?

A. Yes, that is right.

Q. Now, what, if anything, would be charged against such an account? Would that be used to guarantee payments of judgment recoveries, or anything of that sort? [63]

A. If the company became inoperative and there were outstanding claims after a company was adjudged incapable of operating further, from the standpoint of the public good, then they would have the amount of money to liquidate outstanding claims.

Q. In 1939 were there any addition to that fund?

A. In 1939 we took this money down in cash and substituted \$2,000.00 worth of bonds. They were United States Savings Bonds, Series G, so that during 1939 we made an addition to the fund of that difference right there, that \$167.70.

Q. Now, what is that \$2,000.00—the face amount or the real cash value of those bonds?

A. That was the face amount.

Q. So that the sum might be more nearly equal to the exact amount which was withdrawn?

Mr. Cox: Well, I think the Court will take judicial notice that Series G bonds are payable in their face amount.

(Testimony of William Wahl.)

Mr. Crouter: Very well. I hadn't checked that recently. I didn't know that was the type you had.

The Witness: Those are.

By Mr. Crouter:

Q. Now, at the end of 1939, what was the total amount you had with any branch of the State in connection with insurance business?

A. \$2,000.00.

Q. Those bonds? A. Yes, sir. [64]

Q. Was there any change in 1940?

A. Yes, sir.

Q. What change was there?

A. In January we put in \$789.47.

Q. Was that in addition to the bonds?

A. In addition to the bonds. That was in cash,

C. D. Page 71.

Q. Were those payments merely in accordance with the one percent requirement which has been referred to? A. That is right.

Q. One percent of the premium payments?

A. That is right.

Q. Referring to your testimony about your premium income and the allocation of a certain total to the mortuary fund and also a total to operating expense fund, how were those allocations determined?

A. On the basis of the requirement in the policy contract, and those, of course, were approved on the basis of what we looked upon as the State Statute and the State requirement.

Q. Have you given to the Court here all the

(Testimony of William Wahl.)

figures regarding total premium income,—I mean the total amount of premium income on all policies? Is that the total of all?

A. It is. The sum of the two would be the total of it.

Q. And no other funds?

A. And no other funds.

Q. No part of the premiums then have been recorded or allocated to any other account?

A. No, sir.

Q. Then looking at your 1939 figures, which you gave in your testimony on direct, as I recall it, your figures were \$11,990.00 and something, and that amount as given was allocated to the mortuary fund?

A. That is correct.

Q. And you had \$17,858.15 allocated to the expense fund?

A. That is correct.

Q. How much, if any amount, did the State require be allocated for general operating expenses?

A. Well, everything that—any amount outside of the mortuary fund requirements would be for operating expenses.

Q. Do you know whether that was a certain percentage of the State requirements, or what it was based upon?

A. I don't think that it would be upon a specifically named percentage, excepting that it was to be sufficient to carry the necessary reserves. All

(Testimony of William Wahl.)

these contracts are on the same basis and all reflect the American Experience Mortality Table.

Q. Did the Petitioner at the end of 1939 have an exact sum in cash of \$11,990.08 actually maintained in any definite place for this purpose alone?

A. That is right.

Q. Where was that?

A. Either in the bank or in bonds, or on deposit with the State.

Q. Would it be in all three of those places?

A. It could be.

Q. Let's see how this is marked. I mean, is that your original record?

A. No. This is—oh, on my original record? [66]

Q. Let's see how any of those funds are kept on the original record?

A. Well, you take for instance,—let's get back to some of these transfer sheets. We tried to get these in shape last night, and we had our troubles.

Q. If you can show me any total making up a part of that, or representative items in the captions of your accounts, will you do that?

A. Yes, I can do that. Let me have the book of minutes, please. I want a statement of the status of our mortuary fund. This will give it to you, Mr. Crouter.

Q. Do you have some part of an item of \$11,990.00 in mortuary fund for 1939?

A. This is at the end of 1939. This is an analysis of the mortality fund as of December 31st. Net

(Testimony of William Wahl.)

requirement in reserve account, \$14,509.00. That is our figure, isn't it?

Q. This is a loose-leaf notebook. Is that an original record?

A. This is our minute book.

Q. Your minute book?

A. And this report was submitted to the officers of the company by me, as a part of my annual report for 1939, and was made a part of the minutes.

Q. Now, is that a figure which was merely computed in accordance with the State requirement to show what reserve you should have at the end of that year and that you were required by law to have?

A. That is right.

Q. I notice it reads, "Net reserve in accounts for future death claims," and you have an item of \$14,509.99?

A. That is right. [67]

Q. And to make the rest of the total there, there is another net requirement in reserve account for future sick and accident claims, \$149.58; total reserve for all claims, \$14,659.57?

A. That is right.

Q. That was just a bookkeeping record then of the company, wasn't it?

A. No.

Q. To show the legal requirements as to reserves?

A. No—yes, it is a bookkeeping record.

Q. But did it represent any actual funds of that identical amount which was maintained any place?

A. Yes, and here is the history of it. We had

(Testimony of William Wahl.)

deposited in the Valley National Bank, \$5,325.07; deposited in the First National Bank, \$2,500.00; cash on hand, \$432.68; cash on deposit in the State of Arizona, \$2,000.00; secured by note receivable, Mitchell, \$285.00; secured note receivable, Tyler, \$52.16.

Q. Did you have a similar analysis, then, for 1940? A. I believe so.

Q. There is a summary that can be located here for 1940? A. Yes, it can.

Q. With respect to that same exhibit you have here for 1939, and taking that as representative, have you computed the exact percentage so that you can say whether it is within the 50 per cent requirement in some of the policies, or as to all policies, or it is less in some cases?

A. No, except for the first year, the contract provides that in the first year certain percentages which can be less than 25 per cent [68] are to be set aside for mortuary purposes, but after the first year a minimum of 50 per cent, and in all contracts we put 66-2/3 per cent into the mortuary fund.

Q. Why for 1939, then do we have a figure of \$17,000.00 plus for operating expenses, and only \$11,990.00 for your mortuary fund?

A. Oh, I see where our difficulty is. This is the net requirements after having paid the death claims. From our total income in 1939 for mortuary purposes, we received \$11,990.08 and we had an inventory fund from the previous year of \$8,095.46. I would be glad to put this in as an exhibit, if you

(Testimony of William Wahl.)

need this. We disbursed for claims \$5,425.00, leaving a gain in the mortuary fund for 1939 of \$6,564.67, which added to our inventory gives a required mortuary reserve of \$14,659.57, which is that which is set forth in this exhibit that we talked about.

Q. You are familiar with the fact, are you not, that there was considerable controversy between the insurance companies over there and the Insurance Commissioner as to whether, in the first place, the State Insurance Commissioner could regulate your insurance companies in Arizona?

A. There was some controversy on that point.

Q. And wasn't there a suit of the Pioneer Mutual Benefit Association against the Corporation Commissioner on that subject?

A. Yes.

Q. Do you recall that that went to the Supreme Court and was decided by that court in 1942?

A. Yes. [69]

Mr. Cox: I object. The citation can be given to the Court, and this whole thing is a question of law.

Mr. Crouter: I will be glad to stipulate that we can both refer to that case and merely consider it for reference purposes in connection with the case here, if that is agreeable?

Mr. Cox: Yes.

The Court: So understood.

Mr. Crouter: The case is the Pioneer Mutual Benefit Association vs. Corporation Commission, decided in 1942, 123 Pacific 2nd 828.

(Testimony of William Wahl.)

By Mr. Crouter:

Q. In 1939 and 1940, what position did the Petitioner take with respect to the authority of the Corporation Commission to regulate its insurance requirements?

A. May I just elaborate what I really know about that particular situation, which probably will better answer your question.

Q. Well, can you answer the question according to your own knowledge? A. Yes.

Q. I would like to have it answered, as best you can. It has a bearing on the maintenance of a mortuary reserve. That is what we are chiefly interested in.

A. Our position was it was required.

Q. And was a definite sum maintained, in accordance with the State Regulations?

A. That's right.

Q. Even though other companies were contesting it?

A. That is right. They all had to maintain it. [70]

Q. But it was maintained among your own records in the manner you have indicated for 1939?

A. Yes, sir.

Q. Do you know whether 1940 was similar, as to bonds, and cash, and so forth?

A. It was.

Q. Now, referring to the figures you have in that table, like the \$17,000.00 for operating ex-

(Testimony of William Wahl.)

penses, is that a residuary figure also, after expenses for the year have been paid?

A. That is correct.

Q. Do you have any figures there that you could supply us, perhaps in a table, showing the amount at the beginning of the year and the amount expended by months?

A. We can give it for both years.

Q. We might have it worked up so that we could have it presented at the next session on the case here. Mr. Wahl, was there any element of discretion left with the company officers as to how much would be allocated to the mortuary fund and how much for insurance, incidental expenses, and so forth?

A. No, there was not, after the policy contract was approved.

Q. Well, would each policy be specifically approved in the Insurance Office, or just the form of it?

A. No, each policy would be specifically approved.

Mr. Cox: I am sure he is mistaken on that. You mean by "each one," written for each individual to whom it was issued?

Mr. Crouter: That is my question. [71]

The Witness: Oh, I misunderstood you. Each policy form. I am sorry.

By Mr. Crouter:

Q. In connection with the portion maintained for claims, a part of that was just for operating

(Testimony of William Wahl.)

expenses or could be used for operating expenses in connection with claim investigations, couldn't it?

A. Well, the statute under which we were operating provided that expenses incidental to the settlement of claims were an acceptable deduction from our mortuary fund and could be paid out of that fund, but nothing else.

Q. Could attorney's fees, for instance, in contesting a claim?

A. Could be interpreted that way, yes sir.

Q. Do you know as a fact whether attorney's fees were paid out of either of those funds, or it would be out of your expense and claim fund for both of the years involved here?

A. They could have been.

Q. Do you know, in fact?

A. I would have to refer to the ledgers here. There could have been and there might have been. I would have to refer to the ledger to see.

Q. I would like to have you do that before we continue this case. Mr. Wahl, will you kindly examine what I understand to be the 1939 return of the Petitioner and state whether that is the original (handing document to witness)?

A. That is, sir.

Mr. Crouter: The Respondent offer this, if the Court please. I believe it is agreeable to do so out of turn.

Mr. Cox: No objection. [72]

Mr. Crouter: The record shows this is the 1939 original corporation income and excess profits re-

(Testimony of William Wahl.)

turn of the National Reserve Insurance Company for the calendar year 1939, filed with the Collector for the District of Arizona.

The Court: It will be received in evidence as Respondent's Exhibit A.

(The corporation income and excess profits return for 1939 referred to was marked and received in evidence as Respondent's Exhibit A.)

Mr. Crouter: The 1940 return also is offered.

By Mr. Crouter:

Q. Is that the original (indicating)?

A. That is the original, sir.

Mr. Crouter: That is offered in evidence.

Mr. Cox: No objection.

The Court: It will be received in evidence as Respondent's Exhibit B.

Mr. Crouter: That is a similar return for 1940 of the same Petitioner, and it was filed in the District of Arizona.

(The corporation income and excess profits return for 1940 referred to was marked and received in evidence as Respondent's Exhibit B.)

Mr. Crouter: I think that is all, if the Court please.

The Court: Anything further of this witness?

Mr. Cox: I would like to straighten out one matter.

(Testimony of William Wahl.)

Redirect Examination

By Mr. Cox:

Q. You stated one percent was required by the State, Mr. Wahl. I refer to the Act which requires \$1.00 out of every thousand, and I would like to correct that. [73]

Mr. Cox: That is right. I believe the Court will take judicial notice of the laws of the State of Arizona, and would the Court particularly like to have this?

The Court: I suggest you had better put it with the record, so that it will be convenient.

Mr. Cox: I have plenty of copies of this Act here he is referring to.

The Witness: I was mistaken there, Mr. Cox.

By Mr. Cox:

Q. What is that?

A. That is \$1.00 per thousand.

Q. Per thousand.

A. Per thousand of insurance; \$1.00 per thousand of insurance in force.

The Court: If you want to introduce the statute of the State,—

Mr. Cox: Yes, I do.

Mr. Crouter: That is agreeable to me.

The Court: It will be received in evidence as Petitioner's Exhibit 4.

(The statute referred to was marked and received in evidence as Petitioner's Exhibit No. 4.)

(Testimony of William Wahl.)

Mr. Crouter: I would merely like to have the understanding that if there should be any correction between this and the official edition——

Mr. Cox: They may be made, yes. This was furnished to me by the Secretary of State as a mimeographed copy.

The Court: Very well. Anything further?

Mr. Cox: That is all.

Mr. Crouter: Just one question, if the Court please. There is one question I neglected to ask before.

The Court: Very well. [74]

Recross Examination

By Mr. Crouter:

Q. Referring to Exhibit 3 in evidence, and Article XVI to which your attorney referred, I notice that this provides that the death benefit fund shall be created, maintained, and so forth, 50 percent for the first year and then 66-2/3 percent. And then it has this provision, "The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year", a certain certificate and so forth.

A. Yes.

Q. Now, was that provision still in effect in 1939 and 1940?

A. Yes.

(Testimony of William Wahl.)

Q. Was that a part of the fund you referred to here,—those figures? A. That was.

Q. Can you tell us how much of it was used for this purpose?

A. You mean on this exhibit here?

Q. Yes, the funds allocated to mortuary and to claims?

A. No, that exhibit here is after the deduction has been made for refunds to policy holders referred to in here.

Q. Could you also give us figures, then, as to how much was handled under Article XVI here for each of those years? A. For this purpose?

Q. Yes. A. Yes, we can. [75]

Q. Are those figures summarized so that you can give them now, or would you have to work through here to do so?

A. As I say, I owe you an apology for being at a disadvantage here, but as I say I didn't see these books until last night——

Mr. Cox: I would like to ask one question in connection with this cross examination.

The Court: Very well.

Redirect Examination

By Mr. Cox:

Q. Is it not true that the Commission required cash refunds to policy holders under the provision of Article XVI of the by-laws referred to?

A. That is right.

(Testimony of William Wahl.)

Q. And the money referred to therein as a portion of the savings in said fund, that was interpreted as a portion of the net amount set aside during each calendar year; is that correct?

A. That is right.

Q. And the requirement there for 50 per cent of the first year's assessment and 66-2/3 per cent thereafter was in excess of the amount required by the Commission for mortuary purposes?

A. Yes.

Q. The excess premium charged has been by order of the Commission refunded in cash to policy holders; is that correct?

A. Yes, that is right, or the net amount shown in mortuary funds is after making refunds.

Q. To policy holders?

A. To policy holders. [76]

Q. Those refunds are shown in the deficiency statement of the Collector of Internal Revenue, are they not?

A. Yes, that is right.

Q. And the refunds mentioned in that deficiency statement is the same money that is referred to in Article XVI of the by-laws; is that correct?

A. Yes, under the refunds to members, that is right.

Mr. Cox: That is all.

Mr. Crouter: No further questions.

The Court: Very well, gentlemen. You have just the one witness now?

Mr. Cox: Just the one witness, your Honor.

(Testimony of William Wahl.)

The Court: Then we will suspend until 9:30.

The Court: And now that you gentlemen know what Mr. Crouter wants, I suggest you get that data up for him, and as to things that are facts, there is no use in taking the time and the attention of the witness in proving them; when we know they are facts, because that is what we want to get in here.

The hearing in the above-entitled proceeding was resumed on this, the 28th day of November, 1944, before the Honorable William W. Arnold, Judge of The Tax Court of the United States, pursuant to adjournment heretofore taken.

Appearances: (Same as heretofore noted.)

PROCEEDINGS

The Clerk: Docket No. 112638, National Reserve Insurance Company.

Mr. Cox: May it please the Court, during the evening counsel got together and obtained the figures from Mr. Wahl we deemed necessary and [77] we agreed wouldn't need Mr. Wahl further. We ask Mr. Wahl be deemed excused by this Court. Mr. Crouter has some exhibits to offer.

Mr. Crouter: That is agreeable.

The Court: That is all right.

Mr. Cox: I offer the official minutes of the company, the company's copy of the general Order

No. 160-1 from the Arizona Corporation Commission.

Mr. Crouter: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 5.

(The said minutes so offered and received in evidence was marked Petitioner's Exhibit 5, and made a part of this record.)

Mr. Cox: I offer in evidence from the official minutes of the company the company's copy of general Order No. 165-1 from the Arizona Corporation Commission.

Mr. Crouter: I have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 6.

(The said minutes so offered and received in evidence was marked Petitioner's Exhibit 6, and made a part of this record.)

Mr. Cox: May it please the court, that is all of my offer at this time. Mr. Crouter has some offer concerning Mr. Wahl's testimony.

Mr. Crouter: If the court please, I just have a few documents to offer here. The respondent would like to offer at this time a verbatim copy of a document, the original of which was identified by Mr. Wahl yesterday. That is an analysis of the mortality fund as of December 31, 1939. Under his testimony, as I recall, that was contained in the [78] loose-leaf notebook he testified about.

Mr. Cox: The official minutes?

Mr. Crouter: The official minutes.

The Court: Is there any objection?

Mr. Cox: It may be received. I have no objection.

The Court: It will be received in evidence as Respondent's Exhibit C.

(The said analysis so offered and received in evidence was marked Respondent's Exhibit C, and made a part of this record.)

Mr. Cox: Might I ask your Honor, if Exhibits A and B are in evidence, the tax returns?

The Court: My notes so show it.

Mr. Crouter: The respondent also offers, if the court please, a summary from the records of the petitioner headed "Mortuary Fund Balance in Reserve January 1, 1939", and also showing the total reserve at the end of December, December 31, 1940. In other words, it covers the two-year period here. I offer that as Respondent's Exhibit D.

Mr. Cox: I have no objection.

The Court: It will be received in evidence as Respondent's Exhibit D.

(The said summary so offered and received in evidence was marked Respondent's Exhibit D, and made a part hereof.)

Mr. Crouter: The respondent also offers a schedule showing an analysis of mortality fund as of December 31, 1940. This particularly shows the exact location of the various items comprising the total. That would be Exhibit E. [79]

The Court: Do you have any objection?

Mr. Cox: No objection, your Honor.

The Court: It will be received as Respondent's Exhibit E.

(The said schedule so offered and received in evidence was marked Respondent's Exhibit E, and made a part hereof.)

Mr. Crouter: The respondent would also like to offer, the original of the petitioner's general ledger account which is headed "Income-Premium Renewals-Mortality Fund." This comprises three original sheets from the general ledger, with writing and figures on both sides. If this is received we would like to have permission to withdraw the original and substitute a photostatic copy for the original, so the original may be returned.

Mr. Cox: There is no objection.

The Court: It will be received as Respondent's Exhibit F.

(The said general ledger account so offered and received in evidence was marked as Respondent's Exhibit F, and made a part of this record.)

The Court: Leave will be given to withdraw the original upon substitution of a photostatic copy.

Mr. Crouter: That comprises the Respondent's case, if the court please.

Mr. Cox: Mr. Amos Betts is still in the White Memorial Hospital. The Southern Pacific doctor, attending him, advises me that they fear complications, and he will be unable to attend the trial today. I ask that the case either remain open for

the further taking of his testimony at a later time during this calendar or that the court grant permission to take a deposition of Mr. Betts in Phoenix, to be made a part of this record. [80]

He came to California for the purpose of testifying and broke his collar bone on the train on the way over.

The Court: What does counsel for the respondent say?

Mr. Crouter: In that respect my only observation is that I want to cooperate with the court and counsel and secure this man's testimony, if they deem it is essential.

I point out we have the written regulations of the Insurance Department. As I understand he was then and perhaps still is connected with the Insurance Department.

As to the question of taking the deposition at Phoenix, the amount of deficiency is the sum of \$734.53. That is for one year. And there is another year. The total amount is \$1,822.12. While that is not determinative of what action respondent or the court would take in securing evidence, I am wondering whether we couldn't make arrangements to have Mr. Betts testify sometime during this week, if he is able, or take his deposition while he is still in the city.

Mr. Cox: Your Honor, that was my idea. The only thing is if the doctors should deem it necessary for him to be returned home by plane directly from the hospital it would place the petitioner in

a bad position. The petitioner has stated before he will vow to the court Mr. Betts anticipated to testify as he testified on previous cases, that not only was this reserve required but that the approval of the policies was required by order, and that no policy would be approved unless that policy had in it a portion for placing in the mortuary reserve fund at least 50 percent of the premium income after the first year. All policies submitted for approval [81] were submitted by the Corporation Commission of Arizona to actuaries and the actuaries reported to the Commission that the reserves set up in the policies were sufficient to meet the requirements of the American experience table of mortality, plus a $3\frac{1}{2}$ percent accretion or approximation thereof.

Mr. Betts is Chairman of the Arizona Corporation Commission, under which the Insurance Department operates, and we feel that testimony having been given before would not be varied at this time.

The Court: Counsel for the respondent wants the right to cross examine the witness, or could you gentlemen stipulate along that line if it is true that that would be his testimony?

Mr. Crouter: No. The prior testimony related to other years and did not purport to relate to 1939 and 1940 at all. Now, counsel has agreed with me in that respect prior to now.

Mr. Cox: Yes.

Mr. Crouter: He has agreed there is nothing in

his prior testimony that relates to these years. It may have been the practice and procedure of that office, but we have nothing in that prior testimony or anywhere else, that I know of, even in affidavit form, as to exactly what the position and requirement of the Insurance Commissioner was.

We also have this position. It is a matter of fact, as established by the State Supreme Court decision we referred to yesterday, that some insurance companies in that State did not comply with the rules and regulations of that Insurance Commissioner. Now, whether this company did comply has never been thoroughly gone into, as far as I know, as for these [82] years. I don't want to take any advantage here. I don't want to do anything that will make it difficult either for the witness or counsel, but it would seem to me that with that witness already in the city, with the court sitting here and even after the court departs, if it is convenient to take a deposition, then it could be added to this record. I would like to do it while he is here. It wouldn't take very long. It would just save the necessity of an attorney from this office dropping other things and going to Phoenix.

Mr. Cox: Of course, I am willing to come back, if the court so desires, from Phoenix for the purpose of taking the deposition or to make arrangements here. It would seem that a man of that position, and the records will certainly show, I thought that counsel could get together and go to the White Memorial Hospital and stipulate on his testimony, after talking to Mr. Betts.

The Court: We will suspend with this case then until I hear from you gentlemen.

(Thereupon, a recess was taken for three hours, forty-five minutes, at the conclusion of which, the following occurred:)

Mr. Cox: May it please the court, may I state a stipulation concerning the case we had under discussion this morning?

The Court: Yes.

Mr. Cox: The petitioner stipulates that the statement of Amos A. Betts, the transcript will be furnished by Mr. Crouter, and will be received with the same force and effect as a deposition of Mr. Betts, unsigned in any manner, but just as presented by Mr. Crouter tomorrow. [83]

Mr. Crouter: That is agreed upon, and agreeable to the respondent. I may, however, say we have arranged to Mr. Cox will have a copy of that and it will be an agreed and accurate statement of the testimony which has been taken of the witness today.

The Court: That concludes that case?

Mr. Cox: That concludes that case.

Mr. Crouter: That is correct.

(Hearing concluded.)

* * * *

The foregoing is the substance of all the material evidence, oral and documentary, adduced at the trial of the proceeding by The Tax Court of the United States, which is pertinent to the issues on review of the rulings and decision of the Tax Court assigned as error by the Commissioner of Internal Revenue in his statement of points.

/s/ DOUGLAS W. MCGREGOR

CAR

Assistant Attorney General.

/s/ J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue, Counsel for Commissioner.

STATEMENT OF SERVICE:

A copy of Statement of Evidence was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, this 2nd day of August, 1946.

/s/ JOHN W. SMITH

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Received and Filed Aug. 2, 1946. [84]

PETITIONER'S EXHIBIT No. 1.

[Printer's Note]: Par. 11 of General Provisions appended to specimen "Individual or Group Life

Policy," included in Petitioner's Original Exhibit 1, reads:

11. Reserve or Mortality Fund—After the first month 25% of the first year's premium and 66-2/3% of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

[Printer's Note]: Par. 11 of General Provisions appended to specimen "Whole Life Ins. Policy," included in Petitioner's Original Exhibit 1, reads:

11. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's Premium and (66-2/3%) of all subsequent payments will be placed in this Fund, for the purpose of claims and expenses incidental thereto.

[Printer's Note]: Par. 15 of General Provisions appended to specimen "Family Group Union Association," (Whole family protection policy), included in Petitioner's Original Exhibit 1, reads:

15. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's Premium and (66-2/3%) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

[Printer's Note]: Par. 15 of General Provisions appended to specimen "Family Group Union Association," (individual protection policy), included in Petitioner's Original Exhibit 1, reads:

15. Reserve and Mortality Fund—After the first month (50%) of each payment of the first year's Premium and (66-2/3%) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

[Printer's Note]: Par. 15 of the General Provisions appended to specimen "Family Group Union Association," (individual protection certificate), included in Petitioner's Original Exhibit 1, reads:

15. Reserve or Mortality Fund—After the first month (50%) of each payment of the first year's assessment and (66-2/3%) of all subsequent payments, will be placed in this Fund, for the purpose of payment of claims and expenses incidental thereto.

PETITIONER'S EXHIBIT No. 2.

Articles of Incorporation of

National Reserve Insurance Company

Know All Men By These Presents: That we, the undersigned, have this day voluntarily associ-

ated ourselves together for the purpose of organizing and incorporating a National Reserve Insurance Company under the laws of the State of Arizona. And We Hereby Certify:

First: That the name of said corporation shall be National Reserve Insurance Company.

Second: That the purposes for which said corporation is formed are: to engage in, conduct and carry on the business of a National Reserve Insurance Company within the meaning of the provisions of Paragraphs 607, 608, 609, 610, Chapter 14, Article 3, Revised Code of Arizona, 1928, as the same now exists or may hereafter be amended; and generally to do all and everything necessary, suitable, convenient and proper for the accomplishment of the purposes above mentioned, or the attainment of any one or more of the objects hereinbefore named, or which shall at any time appear conducive to, or expedient for the protection or benefit of the corporation and the interests of the members and their beneficiaries.

Third: That the principal place of business of said corporation shall be Phoenix, Arizona, but offices may be established, business transacted and meetings of members and directors [100] held at such places within or outside of Arizona as the by-laws shall provide.

Fourth: The term for which said association is to exist is twenty-five years from and after the date of its incorporation but this association shall have the right and reserves the right to renew or

continue its term of existence from time to time in accordance with the provisions of the laws of Arizona, in that respect.

Fifth: The affairs of this association shall be conducted by a board of directors consisting of not less than three nor more than fifteen directors who shall be chosen from among the members of this association; except that the first board of directors shall be as hereinafter designated. The board of directors of this association shall have the right to adopt by-laws, rules and regulations governing the affairs and operation of this association and its officers and agents; to adopt any and all amendments to such by-laws, rules and regulations; to designate, appoint and fix the compensation of any and all officers, agents, employees and representatives of this association and to designate their authority and duties; to designate, from time to time, the nature and kind of benefits to be paid to and enjoyed by the members of this association and their respective beneficiaries under membership certificates or other instruments pertaining to such memberships, [101] and to designate all rights and obligations of members and in general, regulate and conduct the affairs of this association and to appoint and elect from among the members of the board, a president, one or more vice-presidents, a treasurer and a secretary and such other officers or agents from among the members of the association, including one or more assistant secretaries, as they shall deem necessary or proper. The board shall have such additional powers and rights as

may be conferred upon them by law and/or the by-laws of this association.

Sixth: The association is organized and formed for the purpose above recited and for the protection of its members and their beneficiaries. It shall not have a capital stock and all the activities of the association shall be carried on by it at the expense of and for the benefit of its members and their beneficiaries on the mutual assessment plan provided in and contemplated by the provisions of said Paragraphs 607, 608, 609, and 610, Chapter 14, Article 3, Revised Code of Arizona, 1928.

Seventh: The voting power, property rights and interest of its members shall be equal, dependent upon the nature and kind or class of membership and membership rights held by such member as evidenced by the nature and kind of membership certificate issued to him or her. The association shall have power to admit members who shall be entitled to vote and contribute to, and share in the property of the association and be subject to such obligations and other rights, in accordance [102] with the nature of the membership certificates issued to them respectively, and as provided in the by-laws.

Eighth: The membership certificate issued to a member for such membership, shall not be assignable or transferable, except that the beneficiary named in any membership certificate may be changed from time to time as provided by the by-laws.

Ninth: The names of the directors selected to hold office for the first three months after the incorporation of this association, and until their successors are elected, are as follows; A. H. Horowitz, Phoenix, Arizona; Joseph Meid, Phoenix, Arizona, Ruth Horowitz, Phoenix, Arizona, who were elected on the 24th day of May, 1934, at Phoenix, Arizona.

Tenth: The directors, officers and members of this association and their private property shall be forever exempt from any liability for or in respect to any debts or obligations of the association.

Eleventh: This association does hereby designate Joseph Meid, of Phoenix, Arizona, as its resident agent under the laws of the State of Arizona, upon whom any and all process in any action, suit or proceeding against this association, may be served.

In Witness Whereof: we hereto affix our signatures this 24th day of May, 1934.

A. H. HOROWITZ

JOSEPH MEID

RUTH HOROWITZ [103]

State of Arizona,
County of Maricopa—ss.

Before me, Francis P. Wirer, a Notary Public, in and for the County and State aforesaid, on this day personally appeared A. H. Horowitz, Joseph Meid, and Ruth Horowitz, known to me to be the same persons who signed the foregoing instrument,

and acknowledged to me that they executed the same for the uses and purposes therein mentioned.

Given under my hand and seal of office this 24th day of May, 1934.

My commission expires February 27, 1938.

[Seal]

FRANCIS P. WIRER

Notary Public.

ENDORSEMENT

Arizona Corporation Commission Incorporating Division, Filed May 24, 1934, at 4:30 p.m., at request of Joseph Meid whose address is: 323 Heard Bldg., Phoenix, Arizona.

M. C. HANKINS

Secretary.

By A. O. JONES [104]

PETITIONER'S EXHIBIT No. 3.

[Printer's Note]: Articles II, III, VII (sec. 5), XV, XVI, XVII (sec. 5) and XVIII of Petitioner's Exhibit 3—By-Laws, reads:

By-Laws

of the

National Reserve Insurance Company

* * * *

Article II.

Office & Place

The principal place of business of this Association and its general office shall be in the City of

Phoenix, State of Arizona; branch offices may be established at any other place or places, where the business of the organization may require an office and the Association may transact business in the State of Arizona and in such other States as the Board of Directors may determine.

Article III.

Purpose

The purpose of this Association is to provide and maintain a Beneficial and Co-operative Benefit Association for the protection of its members, and at the same time create a fund from the savings in the Death Benefit Fund, with which to qualify a legal reserve life insurance company. [105]

* * * *

Article VII.

Power of Directors

* * * *

Section 5. The fees and assessments and all other revenues, income or funds of the Association, from whatever sources derived, shall under and by direction of the Board of Directors, be used to discharge any of the obligations of the Association, irrespective of the dates when such obligations were incurred.

* * * *

Article XV.

Membership

Section 1. All applications for membership shall

be in writing and signed by the applicant, except when a minor, in which event the application shall bear the signature of the applicant's parent or guardian.

Section 2. Every application for membership in this Association shall be on such form as the Board of Directors may prescribe and shall set forth over the applicant's signature his or her name, place of resident and such other information as may be required in the application.

Section 3. No application shall be accepted by the Association without the approval of the Board of Directors or the approval of such other person or persons as may be designated by said Board.

Section 4. The fees for membership in the Association shall be of such amounts as are determined by the Board of Directors.

Section 5. Upon acceptance of the application of any person for membership there shall be issued to him or her a membership certificate setting forth the amount of dues and assessments and the amount of benefits payable, which certificate shall be signed by the President and the Secretary. [112]

Section 6. The Board of Directors may issue certificates of membership requiring such dues and assessments and containing such provisions and conditions as in its judgment may seem best for the interest of the Association.

Section 7. All members of this Association shall be entitled to one vote each, in person or by proxy,

at all membership meetings whether regular or called, and that fifty per cent of all members shall constitute a quorum at any such meeting.

Section 8. All assessments shall be paid to the Association at its home office in Phoenix, Arizona, or to such persons as may be designated in writing by the Secretary of the Association. Failure on the part of any member to pay assessments as provided in the certificate of membership shall lapse the membership and void the certificate.

Section 9. Any member who has lapsed his or her certificate of membership may, within one year from date of lapse, make application for reinstatement of such certificate of membership by paying the current month's payment and furnishing to the Association at its home office, evidence of good health and insurability of all the members of the Certificate holder's family included in the certificate.

Section 10. A member may withdraw from membership in the Association by letting any assessment levied upon him go unpaid for more than ten days from the date the assessment is due and payable or by notifying the Association of such intention of withdrawal, without any further liability ever being imposed upon [113] him through such membership having been held.

Section 11. Every member of the Association shall have the right to change his or her beneficiary or beneficiaries by making request in writing to the Association and designating name or names and

address or addresses of the new beneficiary or beneficiaries, which change shall become effective when approved by the Association at its home office.

ARTICLE XVI.

Funds.

Section 1. The Death Benefit Fund of this Association shall be created, maintained and shall consist of Fifty per cent (50%) of the first year's assessment, less the first month's payment; and sixty-six and two-thirds per cent ($66\frac{2}{3}\%$) of all subsequent payments except where a certificate shall lapse and reinstatement shall be dispersed in the same manner as the first year's assessment following the date of issuance of the certificate. The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings.

Section 2. The expense fund of this Association shall be created, maintained and shall consist of only, the membership and registration fees, the first month's payment of assessment and the first month's payment at time of any reinstatement, and

[114] fifty per cent (50%) of the following eleven month's payment and thirty-three and one third per cent (33-1/3%) of all subsequent payments.

ARTICLE XVII.

* * * *

Section 5. No suit in law or equity shall be brought against the Association until ninety days after the death of the member and no suit shall lie against the Association unless begun one year from the date of the death of the member. When there is not sufficient cash in the benefit fund unappropriated from which to pay any death claim then due and payable hereunder, no other action than one to compel the levy of an assessment for the payment of such claim, as herein provided, shall be brought or maintained against the Association. No beneficiary shall have any lien or any claim on any other funds of the Association. [116]

ARTICLE XVIII.

* * * *

Liability of Members.

Section 1. The members of this Association are not and shall not be liable for any debts of this Association or for any other obligations save and except in respect to the payment of the membership fee, dues and assessments. [117]

* * * *

PETITIONER'S EXHIBIT No. 5

Arizona Corporation Commission

General Order No. 160-I

In the Name of the State of Arizona:

To all Benefit Corporations licensed to do business in the State of Arizona:

Greetings:

Pursuant to the authority vested in this Commission by the constitution and laws of the State of Arizona.

It Is Ordered: That from and after the date hereof, Benefit Corporations shall cease issuing certificates of insurance containing non-feiture values, such as cash loans, cash surrender values, paid-up insurance or extended insurance.

It Is Further Ordered that part of each premium be placed in the Mortuary Fund, beginning with the second policy year.

It Is Further Ordered that premium due notices be mailed to each policy holder and a notice of each reinstatement be mailed, calling attention to the policy provision that sets us a new equity as a result of such lapse and reinstatement.

It Is Further Ordered that premiums shall be deemed paid within the grace period, if the envelope in which the premium was mailed bears a post mark dated before midnight of the last day of grace, and that envelopes in which premiums are mailed that bear a post mark dated after midnight of the last day of grace, shall be filed to support any defense the company may care to make.

It Is Further Ordered that all solicitors of insurance for Benefit Corporations shall be deemed agents of the Benefit Corporation to which the solicitor submits applications for insurance [124]

It Is Further Ordered that applications for insurance in Benefit Corporations shall contain no policy provisions that are not also contained in the policy, and that application for insurance in Benefit Corporations, other than for family group insurance, shall be signed by the applicant if applicant is not a minor.

It Is Further Ordered that all agents of Benefit Corporations shall have on their persons, at all times, sample policies when soliciting, and shall in each instance offer to let each applicant read the copy of the policy applied for.

It Is Further Ordered that premiums shall be paid by the policy holder, unless the payee is also a policy holder in the same company.

It Is Further Ordered that all benefits shall be referred to in the policy as maximum benefits if the policy or by-laws contain special assessment or prorated clauses, and that the full amount of each special assessment shall be placed to the credit of the Mortuary Fund.

By order of the Arizona Corporation Commission.

WILLIS G. ETHEL,
Secretary.

Dated at Phoenix, Arizona this 7th day of June, 1939. [125]

PETITIONER'S EXHIBIT No. 6.

Arizona Corporation Commission

General Order No. 165-I

To all Benefit Corporations licensed to transact business in the State of Arizona:

As a matter of sound public policy, all benefit corporations are hereby ordered to issue and deliver to certificate holders checks in payment of all dividends on participating certificates of insurance that are not left with said Benefit Corporations to accumulate or to be added to the face value of the certificates of insurance.

It is also ordered that all Benefit Corporations which declare dividends to holders of participating certificates of insurance, shall declare such dividends with the advice and consent of the Corporation Commission as to the amount of such dividends.

Effective February 16, 1940.

WILLIS G. ETHEL,
Secretary.

Dated this 13th day of February, 1940. [126]

RESPONDENT'S EXHIBIT A

COMPARATIVE BALANCE SHEET

National Reserve Insurance Company

As of Dec. 31, 1938 As of Dec. 31, 1939

ASSETS:

Cash on Hand....	34.75	432.68
Mortality Fund		
(Valley Bank)....	5,325.07	4,415.99

RESPONDENT'S EXHIBIT A (continued)

COMPARATIVE BALANCE SHEET

National Reserve Insurance Company

ASSETS: (continued)

Mortality Fund (First Nat'l Bank)		2,500.00
Stocks and Bonds (Deposited with State)	2,025.00	
Bonds		5,015.58
Cash (Deposited with State)		2,000.00
Notes Receivable	250.00	259.66
Advance to Agents	238.89	254.21
Expense Fund (First Nat'l Bank)	6.21	39.05 (Red)
Clock Account	3.81	
Premiums Pending	1.44	
First Federal Savings & Loan Co. (Dividend De- pository)	100.00	

LIABILITIES:

Notes Payable		400.00
Reserve for future death claims	7,952.34	14,509.99
Reserve for hospi- talization claims ..	143.12	149.58
Accrued Dividends	225.00	
A. S. Gibbons.....	5.00	3.00
Commissions due..	11.72	62.68
Pending and Miscellaneous		24.09
Salary Account		
W. W. Franklin	1,295.56	1,359.01
K. K. Pound....	1,358.71	1,358.18
Profit and Loss....	3,006.28 (Red)	3,027.46 (Red)
	<hr/>	<hr/>
	7,985.17	7,985.17 14,839.07 14,839.07 (Red)

[Letterhead of National Reserve Insurance Company]
[Phoenix, Arizona.]

March 12, 1940

Collector of Internal Revenue

Phoenix

Arizona

Dear Sir:

I am attaching Form 1120 in duplicate, being our Corporation income and excess profits tax return for the calendar year 1939.

The undersigned Company is a non-profit Corporation operating under Arizona House Bill 64, an act relating to benefit corporations and generally referred to as the Benefit Corporation Law of 1937. The income and expense shown in the enclosed return is based upon such membership fees, registration fees, and that portion of renewal premiums which the Corporation is permitted to retain for the payment of agents' commissions and general office operating expense.

Information Forms 1096 have not been submitted as required in Section 9-1 of General Instructions, for the reason that commissions allowed to agents do not come to the Corporation as cash Income, but are retained by the agent as and when paid in the field by the applicant; and we therefore have no control over this situation and no record of what is actually collected. The turnover in agency personnel is so great that it is doubtful that any agent received in excess of \$1,000 if single, or \$2500 if married.

With reference to the item in our balance sheet captioned "Reserve for future death claims," wish to state that the amount shown is the net amount remaining at the end of the year after payment of all claims, and inasmuch as the Corporation has invested no part of this reserve fund for a length of time sufficient to make an earning, it therefore is not an income-determining factor in the enclosed return.

Yours very truly,

NATIONAL RESERVE INSURANCE COMPANY

By: /s/ WM. WAHL,

Assistant Secretary.

WW/dec

[134]

RESPONDENT'S EXHIBIT C

NATIONAL RESERVE INSURANCE COMPANY

ANALYSIS OF MORTALITY FUND AS OF
DECEMBER 31st, 1939

Net Requirement in Reserve Account for Future Death Claims (Excepting Hospitalization)	14,509.99	
Net Requirement in Reserve Account for Future Sick and Accident Claims (Hospitalization)	149.58	
	<hr/>	
Total Reserve for all Future Claims	14,659.57	
Cash and Other Assets held in reserve for claim purposes:		
Deposited in Valley National Bank....	5,325.07	
Deposited in First National Bank.....	2,500.00	
Cash on Hand	432.68	
Cash on Deposit—State of Arizona	2,000.00	
Secured Note Receivable—Mitchell	285.00	
Secured Note Receivable—Tyler	52.16	
Bonds	5,015.58	
Surplus in excess of Requirements	41.84	
	<hr/>	
	14,701.41	14,701.41
		H-1 [143]

RESPONDENT'S EXHIBIT D

MORTUARY FUND

Balance in Reserve January 1, 1939		8,095.46
Gross Amount allocated to Fund, Year 1939	11,990.08	
Paid out for Death Claims 3,828.04		
Paid out refunds to Policy- holders	1,597.93	5,425.97
	<hr/>	<hr/>
Balance of 1939 allocation un- expended		6,564.11
		<hr/>
Total Reserve Fund December 31st		14,659.57
Gross Amount allocated to Fund, 1940	14,514.16	
Paid out for Claims	5,437.60	
Paid out Refunds to Policy- holders	4,154.18	9,591.78
	<hr/>	<hr/>
Balance 1940 allocation unex- pended	4,922.38	
Less allocation to fund on hospitalization in error, based on State Examina- tion, January 14, 1941	241.56	4,680.82
	<hr/>	<hr/>
Total Reserve Fund December 31, 1940		19,340.39
		I-1 [144]

RESPONDENT'S EXHIBIT E

NATIONAL RESERVE INSURANCE COMPANY

Analysis of Mortality Fund as of December 31, 1940

Cash on hand in Company's Office	\$ 832.33	
Cash in Banks	10,415.93	
Valley National	6,586.55	
First National	3,829.38	
Deposit State Treas.	2,789.47	
Gov. and Municipal Bonds	5,015.58	
(Realty) Secured Loans	349.92	
	<hr/>	
	19,393.23	
Surplus		52.84
		<hr/>
		19,393.23

Above is summary of Mortuary Fund as of December 31, 1940, as taken from minutes of January 25, 1941, and which are as reflected by books of the company.

J-1 [145]

GENERAL LEDGER

SHEET NO.

National Reserve Insurance Co.

ACCOUNT
Mortality
Funds

SERVICE LINE FORM 808

STANDARD GENERAL LEDGER

DATE

1938

DEBITS

V

DR.
OR
CR.

BALANCE

V

Jan 6 750

Oct 31 * Balance

31 Error

31

Nov 30 71, 745.50 x

30 * Hoop

30 Inspe

30 Travel

30 Proport 600

30

Dec 31 Decem 7243.26 x

21 Refund

31 *

31

31 Death

31 3 fr.

1939

Jan 31 Jan 98654 ✓

31

Feb 28 Feb 7521 ✓

28 Inspe

28 (As of)

28 (As of) 10074 ✓

Mar 31 Mar 1206

31 6 La

31 Refund

NOV 25 1944

PETITIONER'S

EXHIBIT

RESPONDENT'S

GENERAL LEDGER

SHEET
NO

ACCOUNT:

Income - Premium Renewals -

National Reserve Insurance Co.

ACCOUNT

Maddox
Trust

STANDARD GENERAL LEDGER

STANDARD GENERAL LEDGER

DATE

DESCRIPTION

POSTING
REF

CHARGE

CREDITS

DR.

CR.

CO.

BALANCE

1931

Forward

Oct 31 Adams C.R. Rucker 37th Sephan 74 CD11 ✓

31 Error - Represent Commission 1225

31 " " " 1226

Nov 30 To over her 1225

30 Hoop. Claim black Womack 1215

30 Inspection Fee Parist Claim 1215

30 Traveling Expense - Fair Claim 1225

30 Proportion - Adams (Pay mtd Rucker) 1225

30 Proportion - Adams (Pay mtd Rucker) 1225

Dec 31 To over her 1225

31 Refund - Proportion Premium Pd 74th May 20 1225

31 " " " " " 1225

31 " " " " " 1225

31 " " " " " 1225

31 " " " " " 1225

1932

Jan 31 To over her 1225

31 " " " " " 1225

Feb 28 To over her 1225

28 " " " " " 1225

28 " " " " " 1225

28 " " " " " 1225

Mar 31 To over her 1225

31 " " " " " 1225

31 " " " " " 1225

National Reserve Insurance Co.
GENERAL LEDGERUNT
NO.

ACCOUNT

Income. Premium Renewals

Morbidity
Fund

1913 FORM 202

STANDARD GENERAL LEDGER

DATE	DESCRIPTION	POSTING REF	CHARGES	CREDITS	DR. CR.	BALANCE
19	Forward					
31	Acct 400 Hudson ex 7. #1-3425	3247	88			1051324
30	April	CR 16		89209 ✓		
30	Refund. Annual Renewal Home Insurance	CR 26	1500			
30	Refund by State 50% of fee	CR 26	7500			
30	Death claim Other Carum	CR 26	8100			
30	Cost of check book	CR 26	100			1125323
30	Transfer 2,937 Dow Cost to premium	3250		15001		
30	Dividend 1937 Dow Cost 212	3250	7501			
19	1938 Dividends	3250	159793			
31	May	CR 18		93333 ✓		
31	Acct Chesapeake ex 7. #71-722-723	3247	17001			106423
31	Refund. 11th 15 years claim 1-2047	CR 41	750			
31	1437 Dividend 212	CR 41	750			
31	Death Claim Natche Union	CR 41	10000			1044103
30	June	CR 41		94231 ✓		
31	Acct Edwin Buster Coleman	CR 45	3700			
30	Service Chy by Mark June	CR 56	7101			
30	Transfer from Pandey acct.	3276		5091		1125103
31	July	CR 23		96461 ✓		
31	Death claim - J. S. Weaver #5195	CR 49	30000			
31	Pauline Bryant	CR 49	56			116015
31	Propeller	CR 53	1501			
31	Fred S. McSwain	CR 53	211001			
31	Fred S. McSwain (Refund)	CR 53	5001			
31	June Mass. Chambers	CR 53	283501			

CV

GENERAL
SHEET
NO.

National Reserve Insurance Co

ACCOUNT NO. *Mortality Fund*

DATE		DITS	DR. OR CR.	BALANCE
19	34			
Aug	31	87244.1		12347.52
Sept	30	ay		
	30	72245.1		
	30			
	30			
	30			
	30			
	30			
	30			
Oct	31	7126.1		121694.1
	31			
	31	79401		13063.42
Nov	30	06041		
	30			
	30			13818.58
	30			
Dec	31	01985		
	31	01081		
	31			
	31			14509.99
Jan	31	12156		
	31			15606.55
Feb	29	06184		16668.49
	29			16256.03
Mar	29			
	29			16255.92

GENERAL LEDGER

SHEET
NO.

ACCOUNT

Income Premium Payments - *Morrell's Fund*

National Reserve Insurance Co.

ACCOUNT:

Morrell's Fund

CHARGES GENERAL LEDGER

STATE OF IOWA FORM 808

DATE	DESCRIPTION	POSTING REF	CHARGES	CREDITS	DR. CR.	BALANCE
18 34						
Aug 31	Aug	9725		9725		12347.50
Sept 3	4c N. S. Ck Bldg. - <i>Hand = 3000</i>	9262	13.50			
30	Sept	9727		9727		
30	Death Claim - Fred D. M. Lewis	9057	131.00			
30	- Pauline Bryant	9057	2.00			
30	- Alma Chambers	9057	16.50			
30	- Oliver Kennedy	9057	5.00			
30	- Oliver Kennedy	9057	400.00			
30	Transfer from Pending Acct. - <i>Hand</i>	9262		12.00		12694.10
Oct 31	Death Claim - Harrison D. Weston	9060	400.00			
31	- Nellie Forty	9060	200.00			
31	Oct	9730		9940.10		13063.20
Nov 30	Nov	9733		1060.41		
30	Death	9262	5.00			
30	Death Claim - James Turner	9057	300.00			13818.50
30	- <i>Hand</i>	9262	2.00			
31	Death Claim - Burns	9067	16.50			
31	- <i>Hand</i>	9067	300.00			14509.99
Jan 31	Jan	9731		1121.50		15606.50
31	Credit By State 50% of fee	9071	25.00			16688.49
Feb 29	Feb	9737		1060.41		16756.03
29	Death Claim - Pauline Bryant	9075	700.00			
29	Death Claim - Daisy Price	9075	200.00			
29	Refund Letter from - <i>Hand</i>	9075	12.46			16756.03

K-2

National Reserve Insurance
GENERAL LEDGER

ACCOUNT

City Fund

Life

FORM 808

GENERAL LEDGER

DESCRIPTION BALANCE

✓

	625593	
Acct Life Crozier	626183	✓
Mar	737912	
Death Claim Dor		
Leif	87972	✓
Refund Samuel	87772	✓
Proportion H Frank	87816	✓
Correction 30 94 8	87766	
Turner		
Correction Griffith		
Initials		
Platt		
n. G. Ck Walter W		
Death Claim J.C. P		
Inspection Kearn	88790	✓
Death Claim Ma		
1939 Dividend - Partis		
Death Claim Cohen		
Gravim Expense - Helle		
Medical Fees Weber 300	402982	
Extra Combs. Up - Julem	01417	
Death Claim - M		
Ar		

11-4

National Reserve Insurance Co.

GENERAL LEDGER

ACCOUNT

Income Premium Renewals

Mortality Fund

SHEET

NO.

Life

STANDARD GENERAL LEDGER

DESCRIPTION	POSTING REF.	CHARGES	CREDITS	BALANCE
44 Death Hays Crozier	3278		600 ✓ B	167893
31 Mar	28241		111779 ✓	1676193 ✓
3 Death Nelson Dornan	2079	4000 ✓		1737932
31 Leffert	2079	1000 ✓		1687932
31 Mutual Samuel	2079	400 ✓		1687932
31 Corporation W. Franklin Re	3277		44 ✓ B	1687816 ✓
31 Correction 34 994 Davis	3279		134 ✓ B	1687766
31 Term 451 Han	3279	50 ✓		
31 Correction Leffert 469	28243		113480 ✓	
31 Mutual 4550	3279	69 ✓		
31 Plant 4551	3280	75 ✓		
31 p. 9. Ck. W. L. Leonard	3281	413 ✓		
31 Death Claim J. C. Prescott	2084	466 ✓		
31 Inspection K. L. Lamy	2084	300 ✓		
31 Death Claim - Manire	2084	7500 ✓		17605 ✓
31 1921 Dividend - Partial 100	2084	162193 ✓		
31 Death Claim - Coleman & Rensel	2084	10000 ✓		
31 Insurance Expense - Williams & Kiersey Claim	2084	20000 ✓		
31 Medical Fee 1000 - Jackson 300	2084	1200 ✓		1702982
31 Death Claim - Up - Jackson 1000 - Threlkeld 1000	2084	1565 ✓		1701417
31 Death Claim - Archie Walker	2084	5000 ✓		
31 Arthur Walker	2084	12000 ✓		

K-4

GENERAL

SHEET
NO.

fund

ACCOUNT
NO.

SERVICE OF THE

STANDARD GENERAL LEDGER

DATE		EDITS	✓	DR. OR CR.	BALANCE	✓
1940						
<i>June</i> 30		<i>Dr</i>				
30		<i>Dr</i>				
30		<i>Dr</i>				
30		<i>Dr</i>		120		
30		<i>Dr</i>		2193		
30		<i>Dr</i>		2193	17118 85	
<i>July</i> 31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>			17253 51	
<i>Aug</i> 31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>			16383 76	
<i>Sept</i> 30		<i>Dr</i>				
30		<i>Dr</i>				
<i>Oct</i> 31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
31		<i>Dr</i>				
<i>Nov</i> 30		<i>Dr</i>				
30		<i>Dr</i>				

GENERAL LEDGER

SHEET
NO.

ACCOUNT

Reserve for Mortuary Fund

ACCOUNT
NO.

DATE	DESCRIPTION	POSTING REF.	CHARGES	CREDITS	BAL. CR.	BALANCE
1940						
June 30	Forward					
30	Death Plain J. Burt	CR 94	25.00			
30	Service Chy Burt	CR 94	2.99			
30	Balance 1939 Dist. Declaration	CR 94	42.73			
30	Adj. #4775 Ramsey	CR 55		1.20		
30	See Journal	CR 56		2.93		
July 31	July Income	CR 99		122.53		1711.85
31	Following from Umbrian	CR 99	5.00			
31	Death Plain Mackley	CR 99	500.00			
31	Following from Jackson Plain	CR 99	25.00			
31	Medical Inspection Death Plain	CR 99	240.00			
31	Death Plain Portland	CR 99	100.00			
31	Death Plain Jackson	CR 99	420.00			
31	Service Chy Burt	CR 99	7.48			
31	Washington Adj.	CR 47		1.11		1723.57
Aug 31	Aug Income	CR 251		125.05		
31	Following Jackson	CR 104	6.40			
31	Service Chy Burt	CR 104	7.63			
31	1939 Dividend	CR 10	210.95			
31	Adj. Burch Dec Journal	CR 59	1.25			1638.76
Sept 30	Income Sept.	CR 253		111.44		
Oct 31	Oct	CR 255		125.47		
31	Death Plain - Kincaid	CR 114	25.00			
31	Income - Nov Ramsey	CR 167	100.00			
Nov 30	Death Plain Burt	CR 119	25.00			
Dec 31	Expense Kincaid Death Plain	CR 120	25.00			

GENERAL LEDGER

NT

NO.

ACCOUNT

Reserve for Mortuary Fund

SHEET
NO.

GENERAL LEDGER

DESCRIPTION	POSTING REF.	CHARGES	Y	CREDITS	Y	DR. CR. DR.	BALANCE	Y
Death Claim Harbrough	20119	2500						
" " Goble	20119	2500					1950397	
" " Mercantile Expense	20120	2500						
Death Claim Gibbons	20125	100000						
" " Howe	20125	100000						
" " Adams	20125	20000						
" " County STATE AUDITOR	20125	12500					1924079	
Ref Journal	20107			1874				
" "	20109			620				
" "	20110			272				
" "	20111			118				
" "	20111			167				
" "	20111			167			1927297	
Death Claim Burke	20134	2500						
" " Burke Expense	20135	495						
" " Burke	20141	310					1900987	
1940 Refund Thompson 1 Per Detail	20146	50765	✓				1850202	
1940 " " No. 1 " "	20151	51927	✓				1798275	
1940 " " No. 3 " "	20156	26700	✓				1771585	
1940 " " No. 4 " "	20161	23066	✓				1668519	
1940 " " No. 5 " "	20171	67546	✓				1600973	
Attorney Fees - Brief Federal Bureau of Investigation	20177	13515	✓				1566498	
1940 Refund Bureau of Investigation	20177	430	✓				1526468	
1940 Refund Bureau of Investigation for detail	20184	60037	✓				1526468	

STATEMENT BY AMOS A. BETTS

It is agreed that this is a statement of Amos A. Betts, Chairman of the Corporation Commission of Arizona, taken at the White Memorial Hospital, Los Angeles, California, on November 28, 1944, elicited by questions from Z. Simpson Cox, attorney for petitioner, the respondent being represented by Earl C. Crouter, and that said statement shall be received in evidence in the proceeding of *National Reserve Insurance Company v. Commissioner*, Docket No. 112638, with the same force and effect as a deposition.

Mr. Cox: Mr. Betts, after June 12, 1937, the effective date of the Benefit Corporation Law of Arizona of 1937, did the Commission require presentation of a representative policy on each form to be issued by National Reserve Insurance Company?

Mr. Betts: Yes. Every policy that one of the companies issued must be submitted to the Commission. That has been the policy ever since that law was enacted, and we in turn send it to our actuary in Denver to pass upon as to whether or not it will meet all of the requirements of the law and of our rules and regulations with relation to the reserve fund that is set up for the protection of the policy holders. After the first year that form must never be less than 50% and some of them are more than that. We are advised by our actuary that this fund protects the reserve fund to meet all the requirements of the American Standard Mortality on the basis of 31½%.

Mr. Cox: The National Reserve Insurance Company has been examined every year since that time?

Mr. Betts: Yes.

Mr. Cox: So far as your know, has that company lived up to the requirements of the Corporation Commission?

Mr. Betts: It has. Yes. [152]

Mr. Cox: There was some question raised about some of the companies having trouble with the Commission in not setting aside sufficient funds or questioning the authority of the Commission. Has the Commission ever had any trouble of that nature with National Reserve?

Mr. Betts: None whatever.

Mr. Crouter: Mr. Betts, with respect to any mortality reserve, what specifically was the regulation, if any, as to the use of such a reserve for payment of claims?

Mr. Betts: That reserve can be used for no other purpose except to pay claims and to pay the cost incident to litigation in which a claim may be contested. Absolutely no other manner of expenditure of that fund is permitted.

Mr. Crouter: Was such a fund required to be kept at any particular place or in any particular manner?

Mr. Betts: I don't know that I understand.

Mr. Crouter: I mean in any particular banks or anything of that sort.

Mr. Betts: No, but in connection with the annual examinations of these companies the bank accounts are examined, inspected, to see that they

check with the reports of the companies with respect to not only that fund, but all other funds that they have.

Mr. Crouter: Was there any requirement as to any part of any such fund which had to be kept separate and apart and not used for any litigation expenses or other expenses in connection with contests of claims?

Mr. Betts: Well nothing—I don't think—I don't recall that there has ever been any rule with respect to expenses out of that fund other than the payment of death claims. [153]

Mr. Crouter: But there was no limit on the percentage that could be used for cost of litigation as against costs of payment of claims alone?

Mr. Betts: No, that question hasn't been raised. I would say in our examinations if we find a case in which it appears that the cost of litigation is excessive, we would immediately inquire into it and we would have the power, if we found it excessive, to require that the fund be replenished.

Mr. Crouter: Then as I understand it, in 1939 and 1940 there was no law and no regulation of the insurance department that covered that situation?

Mr. Betts: No, that is right. There was no specific rule by us with respect to the amount that might be expended incident to litigation. Is that what you mean?

Mr. Crouter: Yes.

Mr. Betts: We have never had a case come up that appeared to us to be excessive.

Mr. Couter: Mr. Betts, the record shows a regu-

Par. 15 of General Provisions appended to specimen "Family Group Union Association," (individual protection policy), included in Petitioner's Exhibit 1.

Par. 15 of the General Provisions appended to specimen "Family Group Union Association," (individual protection certificate), included in Petitioner's Exhibit 1.

Petitioner's Exhibit 2, Articles of Incorporation.

Articles II, III, VII (sec 5), XV, XVI, XVII (sec. 5) and XVIII of Petitioner's Exhibit 3—By-Laws.

Petitioner's Exhibit 5 — Arizona Corporation Commission General Order No. 160-I, dated June 7, 1939.

Petitioner's Exhibit 6 — Arizona Corporation Commission General Order No. 165-I, dated February 13, 1940.

Comparative balance sheet as of December 31, 1938 and 1939, with letter dated March 12, 1940 of the National Reserve Insurance Company to the Collector of Internal Revenue, Phoenix, Arizona, all attached to Respondent's Exhibit A.

Respondent's Exhibit C, analysis of Mortality Fund as of December 31, 1939.

Respondent's Exhibit D, Mortality Fund, balance in reserve January 1, 1939.

Respondent's Exhibit E, analysis of Mortality Fund as of December 31, 1940.

Respondent's Exhibit F, Mortality Fund balance (General Ledger) October 31, 1938 to December 31, 1940. [156]

Statement by Mr. Amos A. Betts, Chairman of the Corporation Commission of Arizona, as to reserve requirements imposed upon insurance companies by said Commission.

6. Statement of points to be relied upon by the Commissioner.

7. Designation of the record, proceedings, and evidence to be contained in the record on review.

/s/ DOUGLAS W. MCGREGOR,
Assistant Attorney General.

/s/ J. P. WENCHEL, CAR
Chief Counsel, Bureau of Internal Revenue Counsel
for Petitioner on Review.

Statement of Service:

A copy of Petitioner's Designation of the Portion of the Record to be Printed was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,
Special Attorney,
Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T.C. U.S. Received and filed Aug. 2, 1946. [157]

Statement of Service:

A copy of Designation of Portions of Record, Proceeding and Evidence to be contained in the Record on Review was mailed to Z. Simpson Cox, Esq., 406 Phoenix National Bank Bldg., Phoenix, Arizona, counsel for respondent on review this 2nd day of August, 1946.

/s/ JOHN W. SMITH,

Special Attorney,

Bureau of Internal Revenue.

JWS:RRZ 7-30-46

[Endorsed]: T.C. U.S. Received Aug. 2, 1946.

The Tax Court of the United States
Washington

Docket No. 112638

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

NATIONAL RESERVE INSURANCE COM-
PANY,

Respondent.

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 159, inclusive, contain and are a true copy of the transcript of record, paper and proceedings on file and of record in my office as called

for by the Praeipie in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 27th day of August, 1946.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States. E.M.T.

[Endorsed]: No. 11417. United Stated Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. National Reserve Insurance Company, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed August 31, 1946.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.



No. 11417

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NATIONAL RESERVE INSURANCE COMPANY, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

SEWALL KEY,

Acting Assistant Attorney General.

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HELEN GOODNER,

Special Assistants to the Attorney General.

FILED

DEC 12 1946

PAUL P. O'BRIEN,
CLERK

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Question presented.....	2
Statutes and regulations involved.....	2
Statement.....	2
Statement of points to be urged.....	7
Summary of argument.....	7
Argument:	
I. The taxpayer was not a life insurance company in the taxable years as defined in Section 201 (a) of the Internal Revenue Code.....	9
II. The taxpayer is taxable under Section 207 of the Internal Revenue Code and is liable for deficiencies as determined by the Commissioner.....	36
Conclusion.....	38
Appendix.....	39

CITATIONS

Cases:

<i>Abilene Life Ins. Co. v. Commissioner</i> , 137 F. 2d 191.....	33
<i>American Ins. Co. of Texas v. Thomas</i> , 146 F. 2d 434.....	36
<i>Commissioner v. Monarch Life Ins. Co.</i> , 114 F. 2d 314.....	11, 31
<i>Commissioner v. Netcher</i> , 143 F. 2d 484, certiorari denied, 323 U. S. 759.....	21
<i>Commissioner v. Oregon Mut. Life Ins. Co.</i> , 112 F. 2d 468, affirmed, 311 U. S. 267.....	11
<i>Commissioner v. Security-First Nat. Bank</i> , 148 F. 2d 937.....	22
<i>Commissioner v. Swift & Co. E. B. A.</i> , 151 F. 2d 625.....	14, 16
<i>Continental Assur. Co. v. United States</i> , 8 F. Supp. 474.....	29
<i>Corrigan v. Commissioner</i> , 155 F. 2d 164.....	21
<i>Equitable Life Assurance Society v. Commissioner</i> 33 B. T. A. 708.....	29
<i>Engineer's Club of Philadelphia v. United States</i> 42 F. Supp. 182 certiorari denied, 316 U. S. 700.....	22
<i>First Nat. Ben. Soc. v. Stuart</i> , 134 F. 2d 438, certiorari denied, 320 U. S. 211.....	10, 14, 22
<i>First Nat. Ben. Soc. v. Stuart</i> , 152 F. 2d 298, certiorari denied May 20, 1946.....	10, 14, 16, 17
<i>General Life Ins. Co. v. Commissioner</i> , 137 F. 2d 185.....	14, 16, 18, 24, 32
<i>Helvering v. Illinois Ins. Co.</i> , 299 U. S. 88.....	11
<i>Helvering v. Inter-Mountain Life Insurance Co.</i> , 294 U. S. 686.....	11, 29
<i>Helvering v. Montana Life Ins. Co.</i> , 84 F. 2d 623.....	29
<i>Helvering v. Oregon Ins. Co.</i> , 311 U. S. 267.....	10, 31

Cases—Continued

	Page
<i>Helvering v. Reynolds Co.</i> , 306 U. S. 110.....	14
<i>Helvering v. Winmill</i> , 305 U. S. 79.....	14
<i>Henricksen v. Seward</i> , 135 F. 2d 986.....	21
<i>Jones v. Oklahoma Ben. Life Ass'n</i> , 151 F. 2d 505.....	16, 19, 31
<i>Kaskaskia Life Insurance Co. v. Commissioner</i> , 22 B. T. A. 210....	27, 31
<i>Maryland Casualty Co. v. United States</i> , 251 U. S. 342....	11, 24, 27, 28
<i>Massachusetts Mut. Life Ins. Co. v. United States</i> , 56 F. 2d 897..	29, 31
<i>Midland Mutual Life Insurance Co. v. Commissioner</i> , 19 B. T. A. 765.....	30
<i>Midland National Life Insurance Co. v. Commissioner</i> , 14 B. T. A. 200.....	27
<i>Minn. Mutual Life Ins. Co. v. United States</i> , 66 C. Cls. 481, certiorari denied, 279 U. S. 856.....	29
<i>Mississippi Valley Life Insurance Co. v. Commissioner</i> , 62 F. 2d 1075.....	27, 33
<i>Monteith Bros. Co. v. United States</i> , 142 F. 2d 139.....	12
<i>National Protective Ins. Co. v. Commissioner</i> , 128 F. 2d 948, certiorari denied, 317 U. S. 655.....	12, 33
<i>New York Life Ins. Co. v. Bowers</i> , 283 U. S. 242.....	29
<i>Northwest Steel Rolling Mills v. Commissioner</i> , 110 F. 2d 286, reversed, 311 U. S. 46.....	15
<i>Oklahoma Ben. Life Ass'n v. Jones</i> , 57 F. Supp. 423.....	32
<i>Pioneer etc. Assn. v. Corporation Com.</i> , 59 Ariz. 112.....	20
<i>Pioneer Mutual Benefit Assn. v. Commissioner</i> , decided June 8, 1943.....	21
<i>Reliance Benefit Association v. Commissioner</i> , 2 T. C. 15, dis- missed, 143 F. 2d 597.....	20
<i>Standard Industrial Life Ins. Co. v. Commissioner</i> , 42 B. T. A. 1011.....	14
<i>Stoddard v. Commissioner</i> , 141 F. 2d 76.....	21
<i>Tait v. Western Md. Ry. Co.</i> , 289 U. S. 620.....	22

Statutes:

Arizona Code Annotated (1939):

Sec. 53-601.....	39
Sec. 53-602.....	39
Sec. 53-603.....	39
Sec. 53-604.....	40
Sec. 53-605.....	40
Sec. 53-606.....	42
Sec. 53-609.....	42
Sec. 53-610.....	43
Sec. 53-611.....	43
Sec. 53-612.....	44

Internal Revenue Code:

Sec. 201 (26 U. S. C. 1940 ed., Sec. 201).....	44
Sec. 202 (26 U. S. C. 1940 ed., Sec. 202).....	45
Sec. 203 (26 U. S. C. 1940 ed., Sec. 203).....	45
Sec. 207 (26 U. S. C. 1940 ed., Sec. 207).....	46
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 163 (26 U. S. C. 1940 ed., Supp. V, Sec. 201).....	14

Miscellaneous:

	Page
H. Rep. No. 2333, 77th Cong., 1st sess., p. 109 (1942-2 Cum. Bull. 372)	14
S. Rep. No. 1631, 77th Cong., 2d sess., p. 32 (1942-2 Cum. Bull. 504)	16
Sol. Op. 76, 3 Cum. Bull. 276 (1920)	24
Treasury Regulations 62, Art. 681	14
Treasury Regulations 65, Art. 681	14
Treasury Regulations 69, Art. 681	14
Treasury Regulations 74, Art. 971	14
Treasury Regulations 77, Art. 971	14
Treasury Regulations 103:	
Sec. 19.201 (a)-1	47
Sec. 19.203 (a) (2)-1	47
Sec. 19.207-4	48

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11417

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

NATIONAL RESERVE INSURANCE COMPANY, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE PETITIONER

OPINION BELOW

The opinion of the Tax Court (R. 20-37) and the dissenting opinion (R. 37-39) are reported at 6 T. C. 473.

JURISDICTION

The petition for review involves incomes taxes for the years 1939 and 1940 in the respective amounts of \$1,087.59 and \$734.53, total \$1,822.12. (R. 21.) The taxpayer filed returns for these years with the collector for the District of Arizona. (R. 22.) On July 7, 1942, the Commissioner mailed a notice of deficiency to the taxpayer advising it of deficiencies in income tax for 1939 and 1940 in a total amount of \$1,822.12.

(R. 13-18.) Within ninety days thereafter, on October 1, 1942, the taxpayer filed a petition with the Tax Court of the United States for a redetermination of the deficiencies, under Section 272 of the Internal Revenue Code. (R. 1, 4-18.) The decision of the Tax Court finding that there are no deficiencies in income tax for the years 1939 and 1940 was entered March 15, 1946. (R. 39.) The case is brought to this Court by petition for review filed by the Commissioner on June 3, 1946 (R. 40-44), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the reserve fund, which was maintained by the taxpayer in the taxable years pursuant to Arizona law and its by-laws, not only for payment of claims but for other purposes as well, is a fund held for the fulfillment of life insurance contracts, so that taxpayer may be classed for tax purposes as a life insurance company within the meaning of Section 201 (a) of the Internal Revenue Code and Sections 19.201 (a)-1 and 19.203(a) (2)-1 of Treasury Regulations 103.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are printed in the Appendix, *infra*, pp. 39-49.

STATEMENT

The facts found by the Tax Court may be summarized as follows:

The taxpayer is an Arizona corporation, with principal office at Phoenix, doing business in the

taxable years under the provisions of the Arizona Benefit Corporation Law of 1937 (Arizona Code, Annotated, 1939, Sections 53-601 to 53-622, inclusive). The taxpayer's income tax return for 1939 reported a net loss of \$21.18 and stated that the taxpayer was engaged in the "Assessment Insurance" business and was a non-stock, non-profit, mutual corporation. The taxpayer's return for 1940 reported a net loss of \$5.80 and stated that the taxpayer was engaged in the life insurance business and was a non-stock, non-profit mutual corporation. (R. 22.)

In the taxable years the taxpayer issued only two types of life insurance policy. The "Individual or Group Life" policy provided for the placing in a "Reserve or Mortality Fund" of, after the first month, 25% of the first year's premium, and $66\frac{2}{3}\%$ of all subsequent payments, for the purpose of payment of claims and expenses incidental thereto. The "Whole Life Insurance" policy carried the same provisions with respect to the Reserve or Mortality Fund, except that, after the first month, 50% of the first year's premium and $66\frac{2}{3}\%$ of all subsequent payments were to be placed in the reserve or mortality fund. All policies issued prior to the taxable years carried the same provision as the Whole Life Insurance Policy, except one which incorporated the provisions of the taxpayer's by-laws into the policy. (R. 22-23.)

Article XVI of the taxpayer's by-laws provided for the creation and maintenance of a "Death Benefit Fund," to consist of 50% of the first year's assessment, less the first month's payment, and $66\frac{2}{3}\%$ of

all subsequent payments except where a certificate had lapsed. (R. 23.) It was provided (R. 23-24):

The money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings.

Section 2 of Article XVI of the by-laws provided for the creation and maintenance of an expense fund to consist only of membership and registration fees, the first month's assessment and reinstatement payments, 50% of the next eleven months' payments, and 33 1-3% of all subsequent payments. (R. 24.)

The Arizona Benefit Corporation Law of 1937 required a corporation operating thereunder to state in every benefit certificate issued "the basis or amount to be set aside to the mortuary and reserve fund" and provided (R. 24-25):

A mortuary and reserve fund, exclusive of other assets, may be created, out of which may be paid all benefit claims arising under the certificates, the deposits required to be made with the state treasurer as provided by section 608b, and attorney's fees and necessary expense arising out of the defense, settlement, or payment of any contested or disputed claim. The residue of payments made by members, after

setting aside the amount required for the mortuary and reserve fund, and interest earned by the assets of the corporation, whether deposited with the state treasurer or otherwise invested, may be used for general operating expenses.

The Arizona law also provided for an examination and audit of the books and affairs of each benefit corporation at least biennially for the purpose of verifying the funds as provided in the benefit certificate. Under the law a benefit corporation was required to file a copy of its certificate with the Arizona Corporation Commission before soliciting business and within three days the Commission was required to issue a certificate of authority to transact business if the certificate conformed to the law. (R. 25-26.)

The Commission required any new insurance policy to provide, except for the first year, for the placing of not less than 50% of the premiums in a reserve, which was deemed sufficient to enable the reserve fund to meet all requirements of the American Standard Mortality Table on the basis of $3\frac{1}{2}\%$ interest accretions. The Commission submitted the certificate copy filed with it pursuant to law to its actuary to ascertain whether its provisions met all requirements of law and of the Commission's rules and regulations with respect to the reserve fund set up for the protection of policy holders. (R. 26.)

In each year since 1937 the taxpayer has been examined by and has met the requirements of the Arizona Corporation Commission. (R. 26.)

The taxpayer allocated daily each premium payment to its mortality and expense funds in accord-

ance with the terms of its policies. (R. 29.) The receipts allocated to the mortality fund were credited monthly to an account on its general ledger entitled "Income—Premium Renewals—Mortality Fund." This account was charged with payments on policy claims, the expenses incidental thereto (such as telephone, telegraph, hospital bills, medical, notary, and attorney fees, and traveling expense), all of which were identified with specific policy claims, refunds of excessive premiums to policy holders, and certain minor general expense items (\$34.99 in 1939, and \$47.03 in 1940) not identified with any claim, which were erroneously charged to this fund. The expenses incidental to settling policy claims were not excessive. The refunds to policy holders were reflected in the general ledger account as "dividends" and were made as required by the Arizona Corporation Commission under the provisions of Bylaw XVI, relating to the savings in the death benefit or mortality funds. After refunding the savings to policy holders, the taxpayer's mortality fund or reserve was in excess of the reserve required by the Commission to protect policy holders. (R. 27-28.)

The assets, consisting of cash, a deposit with the state treasurer, secured loans, and government bonds, held by taxpayer in reserve for claim purposes at the end of 1939 and 1940, actually exceeded by small amounts the total reserve fund shown at the end of each year in its mortality fund. (R. 27, 109-111.)

Except for \$206.92 received in 1940 as income from invested funds, the taxpayer's income during the tax-

able years was derived entirely from premiums. (R. 28-29.)

Upon these facts the Tax Court concluded, two judges dissenting, that the taxpayer maintained the reserves required by the laws of Arizona and its policy contracts; that more than 50% of its total reserve funds was held for the fulfillment of its life insurance contracts, and that taxpayer is entitled to be classed as a life insurance company within the meaning of Section 201 of the Internal Revenue Code and the applicable Treasury Regulations. (R. 29.)

STATEMENT OF POINTS TO BE URGED

The Tax Court erred in holding that the taxpayer was a life insurance company in the taxable years 1939 and 1940 within the meaning of Section 201 (a) of the Internal Revenue Code and the applicable regulations and in failing to find deficiencies for these years as determined by the Commissioner. (See R. 46-48.)

SUMMARY OF ARGUMENT

I. In order to be classed as a life insurance company for tax purposes, a corporation must fit within the definition of such companies contained in Section 201 (a) of the Internal Revenue Code. One requirement is that the company must hold a reserve fund for fulfillment of life insurance contracts which comprises more than 50% of the total reserve funds. Under the statutory definition, the regulations applicable thereto, and a further definition of reserve fund in Section 202 (b) of the Code which has been held applicable to assessment insurance companies by two Circuit

Courts of Appeals, it is clear that a fund must be maintained for the sole purpose of maturing claims under insurance policies in order to be considered as a reserve fund held to fulfill contracts. The courts have consistently taken this view.

The Tax Court's findings in this case show that the mortuary fund of the taxpayer, which was the only fund maintained by it other than an expense fund, was subject to be used lawfully under the provisions of Arizona law and of the taxpayer's by-laws and policies, to pay claims and expenses incidental thereto; to pay without limitation attorney's fees and the necessary expense of handling a contested or disputed claim; to make the deposit with the State Treasurer required by Arizona law which was only a deposit for the benefit and protection of taxpayer's members and was not itself available to fulfill claims arising under the taxpayer's contracts; to pay the savings in the fund for the expense of organizing a legal reserve life insurance company; to make refunds to policy holders of excessive premiums, in the nature of dividends; to apply the interest earned by the assets in the fund to payment of general expenses; and to pay hospitalization claims arising on health and accident policies. Under pertinent decisions and the long-standing definition of a reserve set out in the regulation, a fund held for any of such purposes is not a reserve in the technical sense in which it is used in the statute. It follows that the taxpayer maintained no fund which was a reserve fund held for fulfillment of contracts. Even if the mortuary fund

were assumed *arguendo* to be a reserve fund, in part, there is no basis on which it could be determined that more than 50% of the assets in the fund were held separately as a reserve with which to fulfill contracts. Accordingly, the taxpayer is not entitled to be classed as a life insurance company for tax purposes.

II. The taxpayer was clearly a mutual insurance company and is taxable as a mutual company other than life or marine under Section 207 of the Internal Revenue Code, as the Commissioner determined. The deficiencies found by the Commissioner on this basis appear to have been conceded to be correct, but in any case the taxpayer is not entitled to reduce the deficiencies by deducting the net addition required by law to be made to reserve funds or to the deposit with the State of Arizona under Section 207 (c) (1) (A) of the Code because it maintained no fund itself, or on deposit with the state, which qualifies as a reserve fund.

ARGUMENT

I

The taxpayer was not a life insurance company in the taxable years as defined in section 201 (a) of the Internal Revenue Code

The Internal Revenue Code contains special provisions (Sections 201–207, inclusive) dealing with insurance companies, which are divided for tax purposes into life insurance companies, insurance companies other than life or mutual, and mutual insurance companies other than life. The Commissioner determined that the taxpayer in the taxable years was a mutual insurance company other than life and sub-

ject to tax under Section 207 of the Internal Revenue Code (R. 15, 17). The Tax Court sustained the taxpayer's contention that it is taxable in these years as a life insurance company under Sections 201, 202, and 203 of the Code.¹

In order to qualify as a "life insurance company" for tax purposes, the statutory definition of that term must be satisfied. Section 201 (a) of the Code (Appendix, *infra*) provides:

When used in this chapter the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Under this statute it is not enough that life insurance contracts are issued, but in addition the provision with respect to reserve funds must be precisely met. See *First Nat. Ben. Soc. v. Stuart*, 152 F. 2d 298 (C. C. A. 9th), certiorari denied, May 20, 1946; *First Nat. Ben. Soc. v. Stuart*, 134 F. 2d 438 (C. C. A. 9th), certiorari denied, 320 U. S. 211, in which this Court decided that

¹ One advantage of classification as a life insurance company is that premium receipts are excluded from gross income. Under Section 202 (a) of the Code (Appendix, *infra*), the gross income of a life insurance company consists only of income received from interest, dividends, and rent, whereas there is no similar limitation with respect to the gross income of a mutual insurance company other than life under Section 207. Commencing with the Revenue Act of 1921 companies which met the statutory definition of life insurance companies have not been required to include premiums in gross income. See *Helvering v. Oregon Ins. Co.*, 311 U. S. 267.

an insurance company doing business in 1936, 1937, and 1938 under the Arizona Benefit Corporation Law (which, as amended in 1937, is involved in this case) was not a life insurance company as defined by statute for tax purposes in those years, for the reason that it failed to maintain a reserve fund for the fulfillment of life insurance contracts.

It is the Government's position in this case that the Tax Court erroneously classified the taxpayer as a life insurance company in 1939 and 1940, for the reason that the taxpayer's mortuary fund was not a reserve fund held for fulfillment of its life insurance contracts within the meaning of Section 201 (a) and the applicable regulations, since the fund was subject to use for purposes other than fulfillment of such contracts.

It is well settled that the term "reserve fund" as used in the revenue statutes in connection with life insurance companies has a technical meaning and refers to true life insurance reserves, in contrast to solvency or ordinary business liability reserves. See *Helvering v. Inter-Mountain Life Insurance Co.*, 294 U. S. 686; *Helvering v. Illinois Ins. Co.*, 299 U. S. 88; *Commissioner v. Oregon Mut. Life Ins. Co.*, 112 F. 2d 468 (C. C. A. 9th), affirmed, 311 N. S. 267; *Commissioner v. Monarch Life Ins. Co.*, 114 F. 2d 314 (C. C. A. 1st). The first sentence of Section 19.203 (a) (2)-1 of Treasury Regulations 103 (Appendix, *infra*) defines the term "reserve" in accord with its technical meaning, as explained by the Supreme Court in *Maryland Casualty Co. v. United*

States, 251 U. S. 342, 350, and Section 19.201 (a)-1 of the Regulations (Appendix, *infra*) provides that a reserve shall not be regarded as held for the fulfillment of an insurance contract within the meaning of Section 201 (a) of the Code unless it conforms to the definition of "reserve" in Section 19.203 (a) (2)-1.²

The most important characteristic of a life insurance reserve as recognized by Section 19.203 (a) (2)-1 of Regulations 103 is that it is set aside solely as a fund to liquidate future unaccrued and contingent claims arising under insurance contracts, or, as Section 201 (a) of the Code describes it, a fund held for the fulfillment of life insurance contracts. To be sure, Section 201 (a) does not expressly refer to a fund held exclusively for the fulfillment of contracts, but this is its only reasonable interpretation. If a fund is held to pay expenses and to make premium refunds in the nature of dividends, in addition to satisfying claims, the fund is not held for the fulfillment of contracts; it is held for various purposes, of which fulfillment of contracts is only one.

² The phrase "held for the fulfillment of such contracts" should be contrasted with the term "total reserve funds" used in Section 201 (a) of the Code. The former refers only to a true insurance reserve as defined in Section 19.203 (a) (2)-1, whereas in *National Protective Ins. Co. v. Commissioner*, 128 F. 2d 948 (C. C. A. 8th), certiorari denied, 317 U. S. 655, the court held that "total reserve funds" included both a true life insurance reserve and a reserve fund held to liquidate claims on health and accident policies, even though this reserve did not conform to the technical requirements of a true insurance reserve fund.

Moreover, Section 201 (a) requires more than a mere fund held for fulfillment of contracts; it requires a "reserve fund" held for that purpose, and as has been seen under Section 19.201 (a)-1 of Treasury Regulations 103, a reserve fund within the meaning of Section 19.203 (a) (2)-1 of Treasury Regulations 103. That section makes it plain that a fund not maintained solely to liquidate or mature future claims arising under insurance contracts will not be regarded as a true reserve fund. While the Regulation does not use the word "solely," it points out that reserves maintained for purposes other than to pay claims, of which several examples are given (including reserves to pay dividends and expenses), are not included within the term "reserve." The Regulation does not purport to give an all-inclusive list of disqualifying purposes, other than for payment of claims, but, as the Regulation states, enumerates those listed by way of example only. Manifestly, if a fund is held in reserve for any purpose other than to mature or liquidate claims, even though such purpose is not specifically interdicted by the Regulation, it would not be a reserve held for fulfillment of contracts within the test of Section 19.203 (a) (2)-1.

We believe there can be no doubt as to the validity of the provisions of the Regulations in this respect. The Tax Court did not hold them invalid. The same provisions in substantially the same language have appeared in all the Regulations commencing with Treasury Regulation 86, promulgated under the Revenue

Act of 1934,³ and the fact that successive Revenue Acts did not disturb them discloses Congressional ratification.⁴ *Helvering v. Reynolds Co.*, 306 U. S. 110, 115; *Helvering v. Winmill*, 305 U. S. 79, 83. In *First Nat. Ben. Soc. v. Stuart*, 134 F. 2d 438, certiorari denied, 320 U. S. 211, this Court held the regulations valid, and their validity was taken for granted in *First Nat. Ben. Soc. v. Stuart*, 152 F. 2d 298 (C. C. A. 9th), certiorari denied May 20, 1946. See also *Standard Industrial Life Ins. Co. v. Commissioner*, 42 B. T. A. 1011.⁵

³ Earlier regulations were phrased in somewhat different language but were similar in effect. See Articles 971 of Treasury Regulations 77 and 74; Article 681 of Treasury Regulations 69, 65, and 62.

⁴ Far from disapproving the regulation, Congress has adopted it. In Section 163 (a) of the Revenue Act of 1942, it amended Section 201 of the Internal Revenue Code to provide a definition for the term "life insurance reserves" (as H. Rep. No. 2333, 77th Cong., 1st Sess., p. 109 (1942-2 Cum. Bull. 372), states) as—

substantially that contained for many years in the regulations with the addition that the reserves must be based on recognized experience tables.

⁵ *General Life Ins. Co. v. Commissioner*, 137 F. 2d 185 (C. C. A. 5th), did not hold the regulations invalid; it seems to have construed them as not requiring that a reserve be computed actuarially as distinguished from other methods of computation, so long as it was computed as required by law and was irrevocably dedicated to payment of claims. *Commissioner v. Swift & Co. E. B. A.*, 151 F. 2d 625 (C. C. A. 7th), held the regulations invalid only in so far as they require that the reserve funds referred to in Section 201 (a) must be required by law, a holding that is not in accord with the decisions of this Court in the *First Nat. Ben. Soc. v. Stuart* case, *supra*, or with the *General Life* case itself. As pointed out in the preceding footnote 4, Section 201 of the Code itself now defines "life insurance reserves" as, *inter alia*, those actuarially computed and required by law and the second requirement was held to be declaratory of existing law.

Moreover, there is a special statutory provision covering assessment insurance, which in the view of the Circuit Courts of Appeals for the Fifth and Tenth Circuits confirms our position here. The taxpayer was apparently operating under the assessment insurance plan. (R. 22, 96, 100-101.)⁶ Section 202 (b) of the Internal Revenue Code (Appendix, *infra*) defines the term "reserve funds required by law," in the case of assessment insurance, as including amounts deposited with state officers as guaranty or reserve funds, and any funds maintained under the articles of incorporation exclusively for payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.⁷ This definition of course applies to the term "reserve funds required by law" as used in Section 203 (a) (2), in the case of assessment insurance, but since Section 201 (a)-1 of the Regula-

⁶ Its 1939 return stated it was engaged in the assessment insurance business (R. 22); its articles of incorporation stated its activities shall be carried on on the mutual assessment plan (R. 96); and its by-laws refer to amounts payable by members as assessments (R. 100-101).

⁷ The taxpayer did not maintain its reserve fund under a specific provision of its articles of incorporation, but, instead, pursuant to Arizona law and provisions in its by-laws and policies. However, Section 202 (b) would seem to include reserves so maintained. The term charter or articles of incorporation used therein would probably comprehend by-laws, and, moreover, the provisions of state law are deemed to be incorporated in the charter, so that the charter in fact required a reserve fund as provided by state law, even though the requirement was not expressly stated. See *General Life Ins. Co. v. Commissioner*, *supra*; Cf. *Northwest Steel Rolling Mills v. Commissioner*, 110 F. 2d 286 (C. C. A. 9th), reversed on other grounds, 311 U. S. 46.

tions relates the term “reserve fund” in Section 201 (a) of the Code to the term “reserve” in Section 19.203 (a) (2)-1 of the Regulations and since that regulation defines a reserve for purposes of Section 203 (a) (2) of the Code, as well as for other purposes, it has been held that the Section 202 (b) definition applying to assessment insurance companies is pertinent in determining whether this taxpayer maintained a reserve fund within the meaning of Section 201 (a). See *Jones v. Oklahoma Benefit Life Assn.*, 151 F. 2d 505 (C. C. A. 10th); *General Life Ins. Co. v. Commissioner*, 137 F. 2d 185 (C. C. A. 5th).⁸ Under those decisions, if, as we shall show, its reserves were

⁸ *Commissioner v. Swift & Co. E. B. A.*, 151 F. 2d 625 (C. C. A. 7th), seems to have rejected the Tax Court’s view that the term “reserve funds” in Section 201 (a) has the same meaning as in Section 203 (a) (2) and disapproved the regulations insofar as they prescribed that the reserves meant by Section 201 (a) must be those required by law. But this decision is contrary to the holding of this Court in *First Nat. Ben. Soc. v. Stuart*, 134 F. 2d 438, certiorari denied, 320 U. S. 211, and, moreover, the Seventh Circuit in the *Swift* case made no holding that Section 202 (b) does not apply in considering whether a fund of an assessment company meets the criteria contemplated by Section 201 (a) for a reserve fund. In *General Life Ins. Co. v. Commissioner*, *supra*, and *Jones v. Oklahoma Benefit Life Assn.*, *supra*, the courts both treated the definition of “reserve fund required by law” in Section 202 (b) as applicable to the term “reserve funds” in Section 201 (a). Furthermore, Section 163 (a) of the Revenue Act of 1942 amended Section 201 of the Code to incorporate the substance of Section 202 (b) into the general definition of reserves there contained. While the change was not made retroactive, the amendment does reflect an original intent that the definition in Section 202 (b), in the case of assessment insurance, also related to Section 201. Indeed, S. Rep. No. 1631, 77th Cong., 2d Sess., p. 32 (1942-2 Cum. Bull. 504), confirms that this was true under “existing law” prior to the amendment.

not maintained exclusively for payment of policy claims and were subject to other uses, they were not reserves within the meaning of Section 202 (b) and 201 (a) and the taxpayer does not qualify as a life insurance company.

The decisions also support the view that a fund will not qualify as a reserve fund held for fulfillment of contracts, within the meaning of Section 201 (a), unless the fund is held solely or exclusively for this purpose. In *First Nat. Ben. Soc. v. Stuart*, 152 F. 2d 298 (C. C. A. 9th), certiorari denied, May 20, 1946, this Court held that the Society, which did business under the same Arizona statute as is involved in this case, had not sustained its burden of proving, *inter alia*, that its reserve funds held for the fulfillment of contracts comprised more than 50% of its total reserve funds. In that case the evidence showed that the mortuary fund provided for in the Society's by-laws, but which in fact was not separately maintained, could be used for payment, not only of claims, but also of taxes, attorneys' fees, the deposit required by the State of Arizona, and expenses of handling claims. The District Court of Arizona had held in findings of fact and conclusions of law dated June 15, 1944 (See 33 A. F. T. R. 1643), that the Society did not maintain a reserve fund, but even if it had done so, the fund could have been used for taxes and other expenses so that it could not be deemed to have been held solely for fulfillment of insurance contracts, as Section 201 (a) of the Revenue Act of 1938 (identical with Section 201 (a) of the Internal Revenue Code) requires.

The District Court held further that since interest accretions from reserve funds could, under Arizona law, be used for general expenses, the fund departed from the requirements of Article 203 (a) (2)-1 of Treasury Regulations 101 (substantially the same as Section 203 (a) (2)-1 of Treasury Regulations 103) for such a fund. In affirming the District Court this Court expressed no disapproval of these conclusions.

In *General Life Ins. Co. v. Commissioner*, 137 F. 2d 185 (C. C. A. 5th), it was said (pp. 189-190):

It is the universal concept that a life insurance company should maintain a reserve—not for its use but which it cannot invade—for the sole and exclusive protection of its policy holders. Since the reserve is held for the policy holders and not for the Company, Congress has not taxed this reserve as income to the Company. It is contemplated that the reserve is made up of money which the policy holder had put up for his own use and protection and not primarily for the use and protection of the Company. There is no apparent inequity in the policy of Congress in not planning to tax such reserve. However, this reserve should be irrevocably dedicated to the payment of claims arising under the policies. In a sense, it partakes of the nature of an in-choate trust for the benefit of policy holders.⁹

⁹ In the *General Life* case the reserve fund could be used for payment of claims, and also, to a limited extent, for expenses of investigating, settling and contesting claims. The court seems to have overlooked the provision for payment of expenses in reaching the conclusion that the reserve funds in those cases were held for fulfillment of contracts, since the quotation above from the *General Life* case would demand a contrary conclusion upon the

Jones v. Oklahoma Benefit Life Assn., 151 F. 2d 505 (C. C. A. 10th), recognizes the same principle. There the reserve fund itself could be used solely for payment of claims arising under policy contracts, but the interest earned by the fund could be used for payment of general expenses. The court pointed out that, under Oklahoma law and the association's by-laws, interest earned by the reserve fund is not a part of the fund; accordingly, that authority to use the interest for general expenses did not amount to use of the fund itself for payment of general expenses. The court held, one judge dissenting, that the mere investment of the fund to earn interest was not such a use of the reserve fund as to impair it or to amount to an expenditure for purposes other than payment of claims. Thus, it was concluded that the reserve funds themselves were held solely for payment of claims. It is implicit in the opinion that a fund which could be expended for other purposes would not meet the test of the statute.

showing that the fund was not held exclusively for the payment of claims. Even if the court was of the view that payment from the fund of the expenses of contesting claims did not destroy its nature as one held solely to protect policyholders, a view which it did not state and which seems inconsistent with the *First Nat. Ben. Soc.* decision of the Arizona District Court, affirmed by this Court, *supra*, nevertheless the instant case presents a situation in which the reserve fund was not held solely to pay claims and expenses of paying or contesting claims. As will be shown, the fund here could be used to pay dividends and general expenses, to make deposits with the State Treasurer, and to organize a legal reserve insurance company. Hence, the taxpayer's reserve fund cannot, in any case, meet the test for a true reserve fund, even as exemplified by the *General Life* case.

Indeed, we know of no case which takes the view that a reserve fund not held exclusively for fulfillment of insurance contracts will suffice to classify a company as a life insurance company under Section 201 (a).

It is not entirely clear whether the Tax Court in this case understood that the term "reserve fund" in Section 201 (a) refers to a fund held solely for the payment of claims. (See R. 32-37.) It did recognize that a fund held to meet the general operating expenses of a business is not such a reserve as is contemplated by Section 201 (a). (R. 31-32.) But it held that its decision in *Reliance Benefit Assn. v. Commissioner*, 2 T. C. 15, dismissed, 143 F. 2d 597 (C. C. A. 9th), was controlling that the reserve fund maintained qualified as a true life insurance reserve within Section 201 (a). (R. 35.) However, since the *Reliance* case neither considered nor decided whether a reserve fund, shown to have been held for various purposes, of which fulfillment of insurance contracts was only one, qualified as a reserve fund under Section 201 (a),¹⁰ that case can not be dispositive of the present

¹⁰ The point actually decided in the *Reliance* case was that a reserve was required to be established by Arizona law and that the fund prescribed complied with the reserve requirement of the statutory definition, since the prescribed reserve was equivalent to reserves based on experience tables and would enable the company to liquidate its policies as they matured. In view of the decision of the Supreme Court of Arizona in *Pioneer etc. Assn. v. Corporation Com.*, 59 Ariz. 112, 123 P. 2d 828, and the finding in this case that the Arizona Corporation Commission required a benefit company to hold in reserve 50% of all premiums after the first year (R. 26), we do not argue that the taxpayer was not required by law to maintain a reserve fund to the extent of 50% of premiums

case. As the minority opinion here points out (R. 39), even if the point lurked in the record there, the *Reliance* opinion is not authority here, since the point was not decided.¹¹

collected after the first year. Nor do we contend that the reserves must have actually been computed on an actuarial basis, in view of the Tax Court's findings that the Corporation Commission deemed a reserve equal to 50% of premiums after the first year sufficient to meet all requirements of standard mortality tables at a 3½% interest accretion rate; that it submitted all policies to an actuary to see if they met its rules with respect to reserve funds; and that the taxpayer has since 1937 been examined each year and met the Commission's requirements. (R. 26.) See footnotes 4 and 5, *supra*; Cf. Section 19.203 (a) (2)-1 of Treasury Regulations 103; *General Life Ins. Co. v. Commissioner*, *supra*.

¹¹ In a memorandum opinion entered June 8, 1943, under the name of *Pioneer Mutual Benefit Assn. v. Commissioner* (1943 P-H T. C. Memorandum Decisions, par. 43, 266), the Tax Court held that the *Reliance* case was controlling that a group of Arizona benefit corporations were to be classed as life insurance companies for the years 1937 and 1938. The present taxpayer was one of the group covered in the memorandum opinion and, although a protective petition for review was filed in this Court by the Government, it was subsequently dismissed on June 13, 1944, along with the petition for review in the *Reliance* case. See 143 F. 2d 596, 597 (C. C. A. 9th). The point presented now, however, was not presented to or decided by the Tax Court in its memorandum opinion. The earlier decision is not in any way *res judicata* of the present case. In the first place, this is not the sort of question to which the principle of *res judicata* applies. A decision determining a taxpayer's classification for one tax year does not preclude reexamination as to its taxable status for other years. This is so, because the question of classification for each year under a statutory definition must be determined in light of the facts of that period, which, even though similar, are not the same facts as are involved in a determination of status for other years. See *Henricksen v. Seward*, 135 F. 2d 986 (C. C. A. 9th); *Corrigan v. Commissioner*, 155 F. 2d 164 (C. C. A. 6th); *Stoddard v. Commissioner*, 141 F. 2d 76 (C. C. A. 2d); *Monteith Bros. Co. v. United States*, 142 F. 2d 139 (C. C. A. 7th); *Commissioner v. Netcher*, 143

However, even if the Tax Court understood that only a reserve fund held exclusively for fulfillment of contracts would serve to bring the taxpayer within the definition of a life insurance company in Section 201 (a), it failed to apply that principle here. Although it concluded that the taxpayer maintained ¹² a mortuary or reserve fund for the payment of claims arising from its contracts, as required by Arizona law, it did not hold that the reserve fund was held exclusively for the payment of such claims. Nor could it have so

F. 2d 484 (C. C. A. 7th), certiorari denied, 323 U. S. 759; *Engineer's Club of Philadelphia v. United States*, 42 F. Supp. 182 (C. Cls.), certiorari denied, 316 U. S. 700; cf. *Commissioner v. Security-First Nat. Bank*, 148 F. 2d 937 (C. C. A. 9th).

Furthermore, even if the doctrine of *res judicata* were properly applicable to the type of question involved in this case, contrary to the holding in the above cases, the doctrine would not preclude decision of the point argued here, since this point was not decided in the earlier case. Because the present controversy involves taxes for a different year than did the earlier one, a different claim or demand is involved, and only issues actually litigated and decided in the earlier case can operate as an estoppel. *Tait v. Western Md. Ry. Co.*, 289 U. S. 620, 623. Also, the taxpayer has not pleaded that the earlier decision is *res judicata*, so that such a question is not in issue here.

¹² Although it might be questioned from the testimony whether a mortuary or reserve fund was in fact maintained, the Tax Court found that the taxpayer carried a mortuary fund and an expense fund on its books, to which it allocated premiums as received, and that it held actual assets in reserve for claim purposes in excess of the reserve shown in its mortuary fund. (R. 26-29.) Furthermore, its balance sheets for December 31, 1938, and December 31, 1939, carried as a liability amounts listed as "Reserve for future death claims." (R. 107.) Hence, the taxpayer here did more than merely to classify its income as did the taxpayer in *First Nat. Ben. Soc. v. Stuart*, 134 F. 2d 438 (C. C. A. 9th), certiorari denied, 320 U. S. 211, wherein this Court held that no reserve fund was in fact maintained.

concluded upon its findings, which show beyond any doubt that the fund was subject to be used for a variety of payments, which were not the fulfillment of contracts.

However, before discussing in detail the several purposes for which the assets in the mortuary fund could be disbursed, it is observed that the Tax Court found that the taxpayer maintained only two funds, a mortuary fund, and an expense fund which plainly is not a reserve fund, as the Tax Court held. (R. 31.) Although the mortuary fund was held in part to fulfill insurance contracts, the assets held for this purpose were not segregated from the total of the assets held in the mortuary fund, which was subject to use for the additional purposes to be discussed. Also, no such segregation of assets was made on the books nor was the total amount in the mortuary fund divided on the books between the various accounts for which it could be used. Furthermore, the premiums allocated to the mortuary fund were not even classified as between the items for which they were to be held. Hence it follows that the taxpayer in fact maintained no separate fund, within its general mortuary fund, solely for payment of claims, nor did the Tax Court so find. See both *First Nat. Ben. Soc. v. Stuart* decisions of this Court, *supra*.

(1) The taxpayer's insurance policies expressly provided that designated percentages of premiums collected (after the first month) were to be placed in a reserve or mortality fund "for the purpose of payment of claims and expenses incidental thereto."

(R. 23, 92-93.) Section 53-609 (b) of the Arizona Code (Appendix, *infra*) also permitted the reserve fund which was set up to be used to pay "attorney's fees and necessary expense arising out of the defense, settlement, or payment of any contested or disputed claim." (R. 25.) There was no statutory limit and apparently no other restriction upon the amount of the attorney's fees which could be paid from the reserve fund, and the only restriction on payment of the expenses arising out of a contested claim was the statutory one that they be necessary. (Cf. testimony of Betts, R. 121.)

Since the mortality fund was held and could properly be used for these purposes it cannot be considered as a reserve fund exclusively for the fulfillment of contracts. See the second *First Nat. Ben. Soc. v. Stuart* case, *supra*. See also Sol. Op. 76, 3 Cum. Bull. 276 (1920), ruling that a reserve for the expense of investigating and settling loss claims of a casualty insurance company was not a true reserve. It was there pointed out that expenses of investigating claims are in fact ordinary running expenses of insurance companies, and a reserve for this purpose is not maintained to liquidate claims of policyholders, unless indirectly, by protecting the company's business from unnecessary loss. Cf. *Maryland Casualty Co. v. United States*, 251 U. S. 342; Section 19.203 (a) (2)-1 of Treasury Regulations 103.¹³

¹³ In footnote 9, *supra*, it was pointed out that in *General Life Ins. Co. v. Commissioner*, 137 F. 2d 185 (C. C. A. 5th), the court held that a reserve from which expenses of investigating and contesting claims could be paid, limited however to 7.2% of the premium income, qualified as a reserve fund within Section 201 (a).

Furthermore, as the dissenting opinion of the Tax Court suggests (R. 38), the statutory authority to use the fund to pay attorney's fees and necessary expenses arising out of the defense of a contested or disputed claim without any limitation as to amount stamps the fund as held for a purpose in direct antithesis to "fulfillment" of contracts.

The circumstances pointed out by the Tax Court (R. 32) that the expenses actually paid were related to a specific policyholder, were incidental to settlement of claims, were not excessive,¹⁴ and did not reduce the reserves to an amount less than that required by law are not decisive. If the statute requires, as we have shown, that the reserve fund be held for one purpose only, a fund does not meet the statutory test if other items have properly been charged to this fund, no matter how reasonable in amount in connection with a particular claim they may be and no matter if the fund remaining for fulfillment of contracts after such expenses are paid exceeds the legal requirements.

(2) Section 53-609 (b) of the Arizona Code also authorized the payment from the reserve fund of "the deposits required to be made with the state treasurer as provided by Section 53-605." Section 53-605 (Appendix, *infra*) provides for deposit with the state treasurer, to be held in trust for the benefit and pro-

¹⁴ The claim expenses actually paid out of the mortuary fund appear to have totalled \$104.13 in 1939 and \$436.45 in 1940. (R. 16, 18, 26-27.) Exhibit F (R. 112-117) shows the charges and credits to the mortality fund in detail for a period commencing in 1938 and ending in 1941.

tection of the corporation's members, of \$1,000 before the company receives a certificate of authority to transact business; the deposit of a further amount of \$1,000 within a year thereafter, and of a further amount each year equal to one dollar for each \$1,000 of protection in force on December 31 of the preceding year, until a total of \$10,000 has been deposited. The section further provides:

(e) Said deposit may be considered as a part of any required reserve of the corporation and shall not be subject to withdrawal so long as the corporation has any contract or other liability outstanding. If and when the corporation liquidates, dissolves, or merges with another corporation, and there are no certificates or other liabilities not satisfied or assumed, the deposit shall be returned to the corporation upon the order of the commission, and placed to the credit of the fund from which it was taken or paid to the person who may have advanced it.

Thus, the amount deposited was not withdrawable by the depositing corporation during its legal existence or while it had any contract or other liability outstanding. The necessary result is that the deposit was not available at all for fulfillment of insurance contracts, since the depositor must have satisfied, i. e., fulfilled, all its contracts before it could withdraw the fund. The deposit was, however, subject to the lien of any final judgment of an Arizona court and therefore might be reached by general creditors. (Section 53-605 (d) (Appendix, *infra*.) The deposit was clearly one made for the benefit of the corporation's members,

as stated in Section 53-605, as distinguished from one for satisfaction of insurance claims. In *Maryland Casualty Co. v. United States*, 251 U. S. 342, the Supreme Court pointed out that a reserve in the technical sense is held, not only as security for payment of claims, but also as a fund from which the claims themselves are to be paid. The amount deposited with the state therefore was not a reserve fund held for fulfillment of contracts within the meaning of Section 201 (a).¹⁵ Cf. also *Midland Nat. Life Ins. Co. v. Commissioner*, 14 B. T. A. 200, and *Kaskaskia Life Ins. Co. v. Commissioner*, 22 B. T. A. 210, dismissed *sub nom. Mississippi Valley Life Ins. Co. v. Commissioner*, 62 F. 2d 1075 (C. C. A. 8th).

Thus, the mortuary fund could be, and was in the taxable years (R. 54), depleted by payments into the deposit with the State treasurer, which payments themselves were in no sense in fulfillment of contracts, and which did not establish or maintain a reserve fund for the purpose of fulfilling contracts. In its opinion the Tax Court made no reference to these facts, but it seems indisputable that the legal authority to charge

¹⁵ This conclusion is not in conflict with Section 202 (b) of the Internal Revenue Code, *supra*, which provides that in the case of assessment insurance the term "reserve funds required by law" includes sums actually deposited with state officers, pursuant to law as "guaranty or reserve funds." Thus, it is implicit that the deposit must be made as a guaranty or reserve in the accepted insurance sense, that is, to mature or liquidate claims on contracts. Where, as here, the deposit was never available for payment of claims, there was no sum whatever deposited with the state treasurer as "guaranty or reserve funds." Consequently, the deposit here is not the sort referred to by Section 202 (b).

the mortuary fund in this way establishes that it was held for a purpose which does not comply with the statutory test. See the second *First Nat. Ben. Soc. v. Stuart* case, *supra*.

(3) Article XVI of the taxpayer's by-laws authorized its directors to set aside a portion of the savings in the death benefit fund, i. e., the mortuary fund, for the purpose of organizing a legal reserve life insurance company. (R. 23-24.) This provision was to carry out one of the purposes of the taxpayer as stated in Article III of its by-laws. (R. 99.) It is obvious that a payment for this purpose could have no relation to the fulfillment of the taxpayer's contracts. It would represent an expense of a general nature. A fund held for this purpose is not an insurance reserve (cf. *Maryland Casualty Co. v. United States*, 251 U. S. 342; Section 19.203 (a) (2)-1 of Treasury Regulations 103) and is not held for fulfillment of contracts. As J. Disney, dissenting, stated (R. 38):

I am altogether unable to comprehend how a mortuary fund, subject to be drawn upon to set up a legal reserve life insurance company can be said to be held for the fulfillment of the insurance contracts.

It is noted that the majority opinion did not even mention this important fact.

As already observed, the circumstance that the fund may not have been debited in the taxable years with the expenses of organizing a legal reserve company¹⁶

¹⁶ Actually the record is not clear that expenses of this nature were not paid in the taxable year. (R. 80-81.)

is irrelevant. The mortuary fund was established and was "held" to pay such expenses, whether or not any were incurred during a particular year.

(4) Article XVI of the taxpayer's by-laws required the directors to issue each year to each member whose payments had not lapsed a certificate showing the member's share in the savings in the mortuary fund. (R. 24.) Under this provision the taxpayer was required by the Arizona Corporation Commission to make refunds to policyholders of premiums collected in excess of the cost of insurance out of the mortality fund, and the amounts so refunded (\$1,597.93 in 1939 and \$4,154.18 in 1940) were treated in its books as dividends. (R. 26, 27-28.) Quite clearly a fund subject to be depleted by the amounts of excess premiums in the nature of dividends is not a reserve fund held for fulfillment of insurance contracts. Compare the cases which decide that a reserve held to pay dividends or coupons representing dividends to policyholders are mere liability or solvency reserves and not life insurance reserves in the technical sense. *New York Life Ins. Co. v. Bowers*, 283 U. S. 242; *Helvering v. Inter-Mountain Life Ins. Co.*, 294 U. S. 686; *Helvering v. Montana Life Ins. Co.* 84 F. 2d 623 (C. C. A. 9th); *Continental Assur. Co. v. United States*, 8 F. Supp. 474 (C. Cls.); *Massachusetts Mut. Life Ins. Co. v. United States*, 56 F. 2d 897 (C. Cls.); *Minn. Mutual Life Ins. Co. v. United States*, 66 C. Cls. 481, certiorari denied, 279 U. S. 856; *Equitable Life Assurance Society v. Commissioner*, 33 B. T. A. 708, 716-717;

Midland Mut. Life Ins. Co. v. Commissioner, 19 B. T. A. 765. See Section 19.203 (a) (2)-1 of Treasury Regulations 103, which provides that the term reserves does not include amounts maintained for annual and deferred dividends.

The Tax Court seems to have recognized that the payment of these dividends from the mortuary fund was not a payment to fulfil contracts. However, it attempted to justify its holding that the mortuary fund was held to fulfil contracts on the theory that the payment of dividends did not in fact reduce the reserve in the taxable years below legal requirements. (R. 32.) But this, of course, is immaterial to the issue under the statute. Since the taxpayer maintained only one "reserve" fund, its mortuary fund, and since this fund was subject to invasion for premium refunds, it does not meet the statutory test which specifies a reserve fund held only to fulfil contracts.

(5) Section 53-609 (b) of the Arizona Code permitted the interest earned by the assets of the corporation, whether deposited with the state treasurer or otherwise invested, to be used for general operating expenses. No exception is made of interest (R. 25) earned on the assets set aside in a reserve fund. This, we submit, authorizes use of the mortuary fund for such expenses, for the reason that interest earned by the assets comprising a reserve fund is considered as a part of the fund. The classic definition of a reserve fund, stated in *Maryland Casualty Co. v. United States*, *supra*, and incorporated in Section 19.203 (a) (2)-1

of Treasury Regulations 103, is that it is a sum of money, variously computed or estimated, which with *accretions from interest*, is set aside to mature or liquidate future unaccrued and contingent claims. The regulation also states that only funds dependent upon interest earnings for their maintenance will be considered as reserves. And Congress has always considered interest on the reserve fund as of the same character as the principal of the fund, so far as protection for policyholders is concerned. See for a full discussion, *Commissioner v. Monarch Life Ins. Co.*, 114 F. 2d 314 (C. C. A. 1st). See also *Helvering v. Oregon Ins. Co.*, 311 U. S. 267, 269; *Massachusetts Mut. Life Ins. Co. v. United States*, 56 F. 2d 897, 899 (C. Cls.).

As the District Court held in the second *First Nat. Ben. Soc.* case, *supra*, affirmed by this Court, the permission to use interest accretions from reserve funds for general expenses violates the requirements for an insurance reserve fund set out in Section 19.203 (a) (2)-1. While *Jones v. Oklahoma Ben. Life Assn.*, 151 F. 2d 505 (C. C. A. 10th), held that authority to use the interest earned by the fund involved in that case for general expenses did not prevent the fund from qualifying as a reserve fund held to fulfil contracts, this conclusion was reached because (p. 509)—

Under the Oklahoma statutes and the by-laws of the Association, interest earned by the emergency fund of the Association does not accrue to the fund and is no part thereof. Hence,

use of the interest for expenses cannot be said to be a use of the fund.¹⁷

In the instant case Section 53-609 (b) of the Arizona law does not provide that interest earned shall not be part of the mortuary or reserve fund. Nor do the taxpayer's by-laws so provide. Article XVI (R. 23-24) merely prescribes a death benefit fund and an expense fund, but does not stipulate that all interest earned shall go into the expense fund. On the contrary, it is stated that the expense fund shall consist of *only* membership and registration fees, first month's payments of assessments and reinstatements, 50 percent of the following eleven months' payments and 33 $\frac{1}{3}$ percent of all subsequent payments, thus excluding interest earned by the mortuary fund. Thus, the case at bar presents a factual situation with respect to interest different from that in the *Oklahoma Benefit* case.¹⁸

¹⁷ Section 2 (b) of Article II of the Oklahoma Association's by-laws provided:

Any interest accruing from the investment of such funds [reserve fund assessments] shall be collected by the Secretary or Treasurer and become a part of the general expense fund of the Association.

See *Oklahoma Ben. Life Ass'n v. Jones*, 57 F. Supp. 423, 426 (W. D. Okla.).

¹⁸ Although not directly involved here, we doubt the correctness of the conclusion in the *Oklahoma Life* decision, since we think the authorities cited above establish that the interest accretion element is a necessary factor to classify a fund as a true insurance reserve held for fulfillment of contracts within the meaning of Section 201 (a). While the Fifth Circuit has held that a reserve fund may be "variously computed or estimated," as the regulation says, it has not dispensed expressly or by implication with the requirement that the fund shall be maintained by

We submit that on the record here the authority to use interest earned by the assets in reserve for general expenses constitutes an authority to use the mortuary fund for such a purpose and prevents the fund from meeting the criteria for a reserve fund contemplated by the statutory definition.

(6) The balance in the taxpayer's mortuary fund as of December 31, 1939, of \$14,659.57 (R. 26-27) included a provision of \$149.58 for hospitalization on future sick and accident claims (R. 109). Although the exact amount held for this purpose is shown, no separate reserve was in fact maintained to pay hospitalization claims. There are no figures showing the provision for hospitalization in the fund as of December 31, 1940; however, that some amount was included is clear, since an erroneous allocation to the fund for hospitalization was eliminated in 1940. (R. 27.) A reserve held to pay sick and accident claims is not a life insurance reserve fund, although a separate reserve for this purpose may be considered as part of the "total reserve funds" referred to in Section 201 (a). See *National Protective Ins. Co. v. Commissioner*, 128 F. 2d 948 (C. C. A. 8th), certiorari denied, 317 U. S. 655; *Kaskaskia Life Insurance Co. v. Commissioner*, 22 B. T. A. 210, appeal dismissed *sub. nom. Mis-*

interest accretions. Indeed, under the Texas law involved in *General Life Ins. Co. v. Commissioner*, 137 F. 2d 185, and *Abilene Life Ins. Co. v. Commissioner*, 137 F. 2d 191, it seems to have been required that interest should be added to the principal of the reserve fund and held for the same purpose. The record in the *General Life* case shows that the state insurance commissioner so testified.

Mississippi Valley Life Ins. Co. v. Commissioner, 62 F. 2d 1075 (C. C. A. 8th).

As previously pointed out, the taxpayer's mortuary fund was not segregated into a fund, or assets, held to liquidate policy claims and funds held for the several other purposes just discussed. Thus, the mortuary fund was no more than a general fund to meet all the expenses and charges properly payable therefrom. Since, as has been shown, the purposes for which the mortuary fund was held include many, in addition to payment of claims, which entirely violate the concept of life insurance reserves, the fund cannot qualify as a reserve fund held for fulfillment of contracts within Section 201 (a). Cf. the two *First Nat. Ben. Soc.* cases, *supra*.

Moreover, even if it were assumed *arguendo* that some portion of the mortuary fund was held exclusively to fulfil contracts, not only was no separation of a reserve fund for this purpose made in fact within the mortuary fund itself, which would be necessary for taxpayer to prevail, but there was no showing as to even the approximate percentages of the fund held in reserve for this and other purposes.¹⁹ Indeed, it does seem that such an approximation would ~~not~~ be helpful, since there was apparently no limit on amounts usable for expenses of settling and contesting claims and attorney's fees. Also, all the fund attributable

¹⁹ An exception is in the case of the amount held to pay hospitalization claims in 1939 (R. 109), but there was merely a classification within the mortuary fund itself, no separate fund being in fact maintained. For 1940 the record does not show even a separate classification of the hospitalization claim reserve. (R. 111.)

to interest was expendable for general expenses. Even if the view were taken that the portion of the mortuary fund attributable to 50% of premiums collected on all policies after the first year was necessarily held for policy claims, on the theory that the Arizona Corporation Commission prescribed this amount as the minimum reserve requirement (a view which is not tenable since even this minimum amount would be subject to use for expenses), the record does not show what this amount would be.

There is thus no basis on which it could be concluded that more than 50% of the mortuary fund was held to fulfil death claims. To be sure, the actual payments in the taxable years for other purposes seems to have been less than 50% of the total fund,²⁰ but this supplies no proof that more than 50% of the balance of the fund was held for fulfillment of contracts, as distinguished from other purposes for which the fund could lawfully be used.

It is true that the Tax Court concluded that more than 50% of taxpayer's total reserve funds was held for fulfillment of its life insurance contracts. (R. 29.) However, this conclusion did not result from an apportionment of the mortuary fund, but was based on

²⁰ The analysis of the mortuary fund given in the Tax Court's findings (R. 26-27) fails to show the expenses paid in connection with death claims (\$104.13 in 1939 and \$436.45 in 1940—R. 16, 18) which are included in the amounts shown as paid out for (death) claims, nor does it disclose amounts deposited with the state treasurer in those years (\$167.67 in 1939 and \$789.47 in 1940), or expenses, if any, paid to organize a legal reserve company or paid from interest in 1940 (see R. 54, 80-81).

the erroneous holding that the mortuary fund was a reserve fund held for fulfillment of contracts within Section 201 (a), and since the taxpayer had no other reserve fund, that it also represented its total reserve fund. Consequently, the mortuary fund was more than 50%, i. e., all, of the total reserve funds. Since we have shown that the mortuary fund was not a reserve fund held for fulfillment of contracts, it follows that the Tax Court's conclusion must fall and that taxpayer does not fit within the definition of a life insurance company.

II

The taxpayer is taxable under section 207 of the Internal Revenue Code and is liable for deficiencies as determined by the Commissioner

It remains to consider briefly the Commissioner's determination that the taxpayer is liable for deficiencies as a mutual insurance company taxable under Section 207 of the Internal Revenue Code (Appendix, *infra*). If, as has been shown, it is not taxable as a life insurance company, it clearly should be classed as a mutual insurance company other than life or marine. It was a non-profit insurance company (R. 22) and undertook to furnish insurance to its members at cost, refunding excessive premiums to them. It thus was a mutual company. See *American Ins. Co. of Texas v. Thomas*, 146 F. 2d 434 (C. C. A. 5th), and cases cited.

The Tax Court stated (R. 30) that the taxpayer conceded there is a deficiency if the reserves it main-

tained are not reserves "required by law" and if it falls under Section 207. We take this to be a concession that the deficiencies are as determined by the Commissioner, if the taxpayer's mortuary fund is held not to be a true reserve fund under the law and the regulations. But in any case this is the necessary conclusion.

The only issue raised (see petition, R. 5-7) under Section 207 was whether the taxpayer was entitled to a deduction under Section 207 (c) (1) (A) (Appendix, *infra*) which the Commissioner had not allowed it in computing the deficiencies. That section grants mutual insurance companies other than life an additional deduction for—

the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State of Territorial officers pursuant to law as additions to guarantee or reserve funds); * * *

The complete answer to the claim for deduction under this section is that no addition whatever was made to "reserve funds" in the taxable year, because the mortuary fund was not a reserve fund. Furthermore, there is no evidence whatever as to the amount of the net addition, if any, required by the rules of the Arizona Corporation Commission to be made in the taxable years to the mortuary fund. Although the amounts deposited with the state treasurer in 1939 and 1940 were shown, the taxpayer is entitled to no deduction therefor, because the sums were not

deposited as additions to a guarantee or reserve fund. As has been shown, the deposit was only a fund to protect members, and in no sense a reserve fund to liquidate insurance claims.

CONCLUSION

The decision of the Tax Court should be reversed, with instructions to find deficiencies as determined by the Commissioner.

Respectfully submitted,

SEWALL KEY,

Acting Assistant Attorney General.

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Special Assistants to the Attorney General.

DECEMBER, 1946

APPENDIX

Arizona Code Annotated (1939) :

53-601. *Short Title*.—This act may be cited as the Benefit Corporation Law of 1937. [Laws 1937, ch. 36, § 1, p. 107.]

53.602. *Benefit corporations*.—Corporations, not for pecuniary profit, may be formed to provide cash benefits for members and cash benefits for the nominees of deceased members, and shall include all corporations, societies and associations operating an insurance business where funds are provided by mutual contributions, periodical payments, dues or assessments, except those hereinafter exempted. [R. S. 1901, § 898; 1913, § 2215; R. C. 1928, § 607; Laws 1937, ch. 36, § 2, p. 107.]

53-603. *Formation*.—(a) Two hundred [200] or more citizens of the United States, residents of this State for at least one [1] year, may form a benefit corporation by filing articles of incorporation, verified by each of them, stating the general objects of the corporation, its principal place of business, the time of its commencement and termination, the names of the directors and officers by whom the affairs of the corporation are to be conducted and the time of their election, the corporation's name (which shall indicate its general character of business and shall not closely resemble the name of any association, life insurance company, or corporation now licensed to do business in this State), and whether private property is to be exempted from liability for the corporate debts.

(b) When the articles of incorporation have been thus filed and a certified copy thereof

recorded in the office of the county recorder of the county in which its place of business is situated, and appointment of a statutory agent filed, the corporation commission shall issue the corporation a certificate of incorporation. [R. S. 1901, § 889; 1913, § 2216; R. C. 1928, § 608; Laws 1937, ch. 36, § 3, p. 107.]

53-604. *Minimum membership*.—Such corporation shall have twelve [12] months from the date of its certificate of authority to secure a minimum of not less than five hundred [500] members in good standing. Should the membership at any time fall below said minimum, the corporation shall immediately notify the corporation commission. Within ninety [90] days thereafter, or such further time as the commission may allow, the corporation shall increase its membership to said minimum. If the corporation fails to increase its membership within the time fixed, the commission shall revoke its certificate of authority and thereupon such corporation shall liquidate and dissolve. [R. C. 1928, § 608a as added by Laws 1937, ch. 36, § 4, p. 107.]

53-605. *Deposit of money or security*.—(a) Every benefit corporation organized or operating under the provisions of this act, before receiving a certificate of authority to transact business, shall in addition to the requirements of section 609b [§ 53-611], deposit with the state treasurer, to be by him held in trust for the benefit and protection of the corporation's members, the sum of one thousand dollars [\$1,000]. Thereafter a further sum of one thousand dollars [\$1,000], divided into twelve [12] equal monthly payments, beginning thirty [30] days after the certificate of authority is issued, shall be likewise deposited with the state treasurer. Failure to pay any such monthly payment shall automatically cancel the corporation's certificate of authority.

(b) In addition to said deposits every such corporation shall, not later than February 1, 1940, and on or before February 1 of each year thereafter, deposit with the state treasurer, to be by him held in trust as hereinafter provided, for the benefit and protection of the members of the corporation, a further sum equal to one dollar [\$1.00] for each one thousand dollars [\$1,000] of protection in force on December 31 of the preceding year, beginning as of December 31, 1939, until a total of ten thousand dollars [\$10,000] has been so deposited.

(c) The deposits prescribed by this section shall be subject to withdrawal from the state treasury in whole or in part only on the order of and as directed by the corporation commission, but may, with the commission's approval, be invested in United States or state bonds, which shall be placed with and assigned to the state treasurer and held by him as provided for the original deposits. Subject to approval by the commission any such securities may be exchanged for others of like amounts. The interest on said securities shall be payable to the corporation depositing the same.

(d) Any unsettled final judgment of a court of this state shall be a lien on the deposits of money or securities prescribed by section 608b [§ 53-605], and subject to execution after thirty [30] days from entry of final judgment. If said deposit is depleted thereby it shall be replenished within ninety [90] days.

(e) Said deposit may be considered as a part of any required reserve of the corporation and shall not be subject to withdrawal so long as the corporation has any contract or other liability outstanding. If and when the corporation liquidates, dissolves, or merges with another corporation, and there are no certificates or other liabilities not satisfied or assumed, the deposit shall be returned to the corporation upon the order of the commission,

and placed to the credit of the fund from which it was taken or paid to the person who may have advanced it. [R. C. 1928, § 608b as added by Laws 1937, ch. 36, § 5, p. 107.]

53-606. *Benefit certificate*.—(a) Every benefit certificate issued by any such corporation shall specify the maximum amount not exceeding five thousand dollars [\$5,000], on the life of any individual, to be paid on the happening of the contingency therein stated, and shall state the basis or amount to be set aside to the mortuary and reserve fund. The certificate, including any written amendment thereto, and, at the option of the corporation, the application therefor, and the bylaws of the corporation, shall constitute the entire contract between the corporation and the member, and the applicant shall see that all facts required to be stated are set forth in the application.

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53-609. *Payments and funds*.—(a) Every benefit corporation shall provide in its benefit certificate for periodical payments or dues sufficient to pay benefit claims and general operating expenses as stipulated therein.

(b) A mortuary and reserve fund, exclusive of other assets, may be created, out of which may be paid all benefit claims arising under the certificates, the deposits required to be made with the State treasurer as provided by section 608b [§ 53-605], and attorney's fees and necessary expenses arising out of the defense, settlement, or payment of any contested or disputed claim. The residue of payments made by members, after setting aside the amount required for the mortuary and reserve fund, and interest earned by the assets of the corporation, whether deposited with the State treasurer or otherwise invested, may be used for general operating expenses. [R. S. 1901, § 900; 1913, § 2217; rev., R. C. 1928, § 609; Laws 1937, ch. 36, § 9, p. 107.]

53-610. *Examination.*—At least once in every two [2] years the corporation commission shall require the books and the affairs of each benefit corporation to be examined and audited by an accountant designated and commissioned by it, for the purpose of verifying the funds as provided in the benefit certificate thereof. For such purpose the commission and its auditor shall have free access to all books, papers and accounts of the corporation. The cost of any such examination and audit shall be paid by the corporation, but it shall not be required to pay for more than one [1] such examination and audit in any one [1] year, nor to exceed twenty-five dollars [\$25.00] for each one thousand [1,000] certificates or fraction thereof in force at the time of such examination except that a corporation chartered under the laws of another state shall also pay the traveling expenses of the accountant designated by the commission. All such costs shall be paid upon the completion of the audit or examination. [R. C. 1928, § 609a as added by Laws 1937, ch. 36, § 10, p. 107.]

53-611. *Certificate of authority to transact business.*—(a) Before any benefit corporation shall solicit applications for benefit certificates it shall file a copy of its certificate with the corporation commission and evidence that it has made the deposit required by section 608c [§ 53-606]. If the certificate conforms to the requirements of this act, the commission shall within three days issue a written certificate of authority to the corporation to transact business.

(b) Upon presentation to the commission of prima facie evidence that any benefit corporation is wilfully violating the provisions of this act, the commission shall immediately notify such corporation, stating the manner in which it is alleged the law is being violated. If it appears to the commission that the corporation

is continuing such violation, it shall cite the corporation to appear within thirty [30] days to show cause why the alleged violations should not be remedied. If upon said hearing the commission shall find that the corporation is violating the provisions of this act in the particulars stated in the citation, it shall serve a written notice of its decision upon the corporation, which shall be subject to the rights of appeal hereinafter provided. Should the corporation not appeal from such decision, or if it appeal and the appellate court shall uphold the decision of the commission, the corporation shall comply with the order of the commission within ten [10] days thereafter, and upon its failure so to do, the commission may revoke the certificate of authority of such corporation. [R. C. 1928, § 609b as added by Laws 1937, ch. 36, § 11, p. 107.]

53-612. *Exemption from attachment.*—No money paid or to be paid for any benefit, as provided in a certificate issued by a corporation organized or operating under the provisions of this act, shall be liable to attachment or other process, nor may it be seized, taken, appropriated or applied by any legal or equitable process, nor by operation of law to pay any debt or liability of any member of his nominee, except as may be provided in the benefit certificate. [R. C. 1928, § 609c as added by Laws 1937, ch. 36, § 12, p. 107.]

Internal Revenue Code:

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) *Definition.*—When used in this chapter the term “life insurance company” means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts

comprise more than 50 per centum of its total reserve funds.

* * * *

(26 U. S. C. 1940 ed., Sec. 201.)

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) *In General*.—In the case of a life insurance company the term “gross income” means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * *

(b) *Reserve Funds Required by Law, Defined*.—The term “reserve funds required by law” includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

(26 U. S. C. 1940 ed., Sec. 202.)

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General Rule*.—In the case of a life insurance company the term “net income” means the gross income less—

* * * *

(2) *Reserve Funds*.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of $3\frac{3}{4}$ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insur-

ance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of $3\frac{3}{4}$ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(26 U. S. C. 1940 ed., Sec. 203.)

SEC. 207. [as amended by Section 205 of the Revenue Act of 1939, c. 247, 53 Stat. 862].
MUTUAL LIFE INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Imposition of Tax.*—

(1) *In General.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every mutual insurance company (other than a life insurance company) a tax at the rates provided in section 13 or section 14 (b).

* * * * *

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual Insurance Companies Other Than Life Insurance.*—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * *

(26 U. S. C. 1940 ed., Sec. 207.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.201 (a)-1. *Life insurance companies: Definition.*—The term “life insurance company” as used in chapter 1 is defined in section 201 (a). In determining whether an insurance company is a “life insurance company” as defined in section 201 (a), no reserve shall be regarded as held for the fulfillment of an insurance contract unless it conforms to the definition of “reserve” contained in section 19.203 (a) (2)-1.

SEC. 19.203 (a) (2)-1. *Reserve funds.*—In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is $3\frac{3}{4}$ percent of the mean of such reserve funds held at the beginning and end of the taxable year.

SEC. 19.207-4. *Required addition to reserve funds of mutual insurance companies (other than life).*—Mutual insurance companies, other than life insurance companies, may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds “required by law” include not only reserves required by express statutory

provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. For a general definition of "reserve fund" see section 19.203 (a) (2)-1.

No. 11417

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

Commissioner of Internal Revenue, Petitioner
v.
National Reserve Insurance Company, Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

ALFRED C. LOCKWOOD
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LORNA E. LOCKWOOD
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Attorneys for Respondent

FILED

JAN 29 1947

PAUL P. O'BRIEN,
CLERK

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

No. 11417

Commissioner of Internal Revenue, Petitioner,
v.
National Reserve Insurance Company, Respondent

BRIEF FOR THE RESPONDENT

The statement of facts set forth in petitioner's opening brief is substantially correct and the question to be determined is really one of law, to-wit: whether the Mortuary and Reserve Fund, which, it is admitted by petitioner, was established and maintained by respondent in strict conformity with the law of Arizona and the requirements of its Corporation Commission, justified the Tax Court in holding respondent to be a life insurance company within the meaning of Sections 201 and 202 of the Internal Revenue Code. Petitioner does not contend that this fund was not sufficient at all times to meet all the requirements of the American Standard Mortality Table on the basis of $3\frac{1}{2}\%$ for the "fulfillment" of respondent's insurance contracts, after deducting from said fund all withdrawals made or permitted therefrom during all of the time involved herein, or that the reserve so maintained was not more than 50% of all the total reserve funds of respondent.

As we understand his argument, it is that because certain withdrawals were permitted to be made from the reserve fund thus maintained, it lost the character which it otherwise would have had as a proper reserve fund "held for the fulfillment of such contracts" as were issued by respondent for life insurance and annuities so as to qualify it as a life insurance company under Sections 201 and 202, *supra*, or to put it more definitely, that any reserve from which funds could legally be withdrawn for any purpose except annuities or payment of **death claims** under life insurance policies, could not qualify under the Federal statute, no matter though such reserve was at all times required by State law to be and actually was maintained sufficient to fulfil **all** the provisions of its insurance and annuity contracts.

What are these matters which the petitioner contends removes respondent's Mortuary Fund from the required status? They may be divided into four (4) groups. The first is a small number of bills which were erroneously charged in the books to the Mortuary Fund but which obviously should have been charged to the expense fund maintained by respondent. Petitioner tacitly admits that these items, which the evidence shows were merely errors in bookkeeping and not intentional charges to the wrong fund, cannot be considered as showing that the Mortuary Fund does not properly qualify under Sections 201 and 202 *supra*, so we say no more in regard to them.

The second class of charges which petitioner contends disqualified the Mortuary Fund maintained by respondent are those allowed under Article XVI of the by-laws of respondent, and the insurance policies issued thereunder, which article reads so far as material, as follows:

“The Money in the Death Benefit Fund shall be used for the payment of death losses, however, the Board of Directors may set aside a portion of the savings in said fund for the purpose of organizing a legal reserve life insurance company, and shall issue in January of every year beginning January 1936 a certificate of evidence to each member of the Association who has paid twelve consecutive monthly payments without lapsing, showing his or her pro rata in such savings.”

As this court well knows, the premiums of a life insurance company are supposed to be sufficient to cover:

(1) The necessary reserves to fulfil its insurance contracts; and

(2) An amount sufficient to pay all the overhead expenses of operating the company.

In order to be sure that this is done, it is the custom of life insurance companies to charge a premium sufficient to fully meet these two requirements under all conceivable conditions, and almost invariably it is found at the end of the year that the premium charged and paid was larger than was necessary. This is a saving or surplus which in a stock company belongs to the corporation and may be used to pay dividends, properly so-called, to the stockholders, or for any other purpose within the articles of incorporation. In a non-profit mutual company, such as respondent, however, this excess belongs to the **policy holders** and not the **corporation** and is not a true **dividend** but a refund to the policy holder in accordance with his insurance contract.

United States L. Ins. Co. v. Spinks
126 Ky. 405, 96 SW 889, 209 U.S. 539,
52 L Ed. 917.

Penn Mut. L. Ins. Co. v. Lederer,
252 U.S. 523, 64 L. Ed. 598.

It is true Sec. 19.203 (a) (2)-1 of the Regulations, states that these refunds are not to be considered as part of the reserve under Sections 201 and 202, *supra*.

Assuming this regulation to be a valid one, the record shows respondent did not attempt to include these refunds as part of the reserve which it contends qualifies it as a life insurance company under those sections. T.R. 81, 82.

The factual situation shown by the record is as follows: Sec. 53-609 AC 1939 requires that a mortuary and reserve fund be fixed by the Corporation Commission for the purposes set forth therein.

Pioneer Mut. Benefit Assn. v. Corp. Com.
123 Pac. 2d 828.

This was done by setting aside a certain percentage of the premiums. For the reasons above set forth, this was more than was needed to maintain the reserve for death claims required by Sections 201 and 202, *supra*, which had been calculated under the American Standard Mortality Tables at $3\frac{1}{2}\%$ interest. T.R. 119. This surplus, or savings, belonged to the existing policy holders, pro rata. Unless in some manner it was legally withdrawn, it would remain in mortmain forever. According to petitioner's theory the only manner in which this could have been done, and still qualify the respondent as a life insurance company, would have been to **retain** this savings as a **deferred** refund, payable only at the **death** of the policy holder, or perhaps

to transfer the savings annually to another fund by order of the directors, and **then** refund to the individual policy holders from the new fund thus created.

The effect of the first course was well illustrated in the famous insurance scandals at the beginning of the century, as a result of which most states prohibited the deferred dividend, while the second course was in substance, though not in form, that actually followed by respondent under the direction of the Corporation Commission. T.R. 82. Under the plan followed it was impossible for the Mortuary Reserve to be depleted below the requirements of the Federal Statute by **reason of these refunds.**

It would be indeed a harsh and extremely technical construction to hold that Congress intended when it enacted Sections 201 and 202, *supra*, that the procedure followed by respondent under the orders of the Corporation Commission deprives it of its character as a life insurance company. The old saying "the letter slayeth but the spirit giveth life" is as true today as it was two thousand years ago. Our courts have held repeatedly that any doubt or ambiguity in the law should be resolved in favor of the tax payer, and it was never intended that our tax officials should, like Shylock, demand their pound of flesh.

The third class of payments which petitioner contends disqualified respondent's reserve fund, consisted of the payment of certain expenses, such as attorneys' and investigation fees, from the Mortality Fund. We think the construction placed by petitioner on the nature of these payments is both illogical and unwarranted. The Mortality Fund must be held to protect the "fulfillment of such contracts." According to petitioner's contention, the only "fulfilment" of a contract is

when a claim which is made thereunder is paid without investigation as to whether the contract requires its payment or not, and the employment of an investigator to determine the facts or an attorney to resist the payment of an unjust claim is not in "fulfillment of such contract." We think it is just as essential to the "fulfillment" of a contract to defeat an unjust claim thereunder as it is to pay a just one. Suppose for instance, a claim is made for a certain sum under a contract, when the officers of the company have reason to believe that all the facts, when they are discovered, will show that no payment is due. Is it not in "fulfillment of such contract" to investigate and determine those facts? Certainly if the claimant brings suit on such a claim against a company, the employment of competent attorneys to resist the claim is in "fulfillment of such contract." The record shows that payments of this class were only made in reasonable amount and under circumstances that would justify the investigation of the **particular contract** to see whether it would be a "fulfillment" thereof to pay it or fight it. T.R. 121. Evidently the Arizona legislature considered these matters as properly connected with fulfillment of insurance contracts rather than general expenses, (Sec. 53-609, AC 1939) and the Corporation Commission watched carefully to insure they did not unduly deplete the reserve fund. T.R. 121.

This covers the three principal objections made by petitioner to the sufficiency of respondent's reserve fund. The fourth is that the Arizona law permits interest earned by the fund to be used for general expenses. Section 53-609 AC 1939 is cited as authorizing this. On the contrary it explicitly states that such earnings are **not** to be used for operating expenses. Both respondent

and the Arizona Corporation Commission used the American Standard Mortality Tables in calculating the reserve fund. These tables are based on the theory that the amount needed is composed of certain funds paid by the policy holder **plus 3½ % interest thereon**. Necessarily the interest earned by respondent was required by the law and regulations of the Corporation Commission to be added to the reserve fund to maintain it **as it was calculated**, and the presumption is that the law was complied with. There is no evidence to the contrary.

Petitioner states that the District Court held in *First Nat. Ben. Soc. v. Stewart*, which was appealed to this court and affirmed in 152 Fed. 2d 298, "The permission to use interest accretions from reserve funds for general expenses violates the requirements for an insurance reserve fund set out in Sec. 19. 203 (a) (2)-1" (Pet. Brief, p. 31). It is true that the conclusions of law of the District Court do in substance hold that the Arizona Code permits interest to be used for general expenses, but in view of what we have pointed out in the preceding paragraph, we think the conclusion is necessarily erroneous. No state court has ever so held.

Petitioner also relies strongly on the case of *First National Benefit Society v. Stewart*, 134 Fed. 2d 438, decided by this court. We have examined the case carefully and fail to see its applicability to the present situation. It was tried in the District Court of Arizona and was a suit asking for refund of a payment claimed to have been erroneously made, on the ground that the petitioner had paid a tax not required by law. The vital issue was whether petitioner was a life insurance company under Sections 201 and 202 *supra*. Among the findings of fact by the trial court were the following:

“The plaintiff was not required either by express statutory provisions or by the rules and regulations promulgated in the exercise of a power conferred by statute to create or maintain a reserve for the fulfillment of its insurance contracts.

“The plaintiff has not voluntarily created or maintained a reserve fund for the fulfillment of its life insurance contracts.”

At that time, the State statute requiring the reserve fund under which respondent herein is operating, was not in force, nor did the evidence show a proper reserve was **voluntarily** maintained. The findings were obviously based on a factual situation very different from that existing in the present case. The matter came before this court on appeal, and the judgment was affirmed on the grounds that the regulations of the Treasury Department required a certain reserve in order for petitioner to qualify as a life insurance company under Sections 201 and 202, *supra*, and that the evidence failed to show that a statute, rule or regulation of the State of Arizona required such a reserve or that one had been voluntarily kept. The court in considering the evidence, stated:

“The evidence goes no further than to show that appellant classified its income, but classifying income is not maintaining a reserve. Likewise, a requirement of the by-laws requiring maintenance of reserves does not show that appellant maintained such reserves.”

In the present case the Tax Court, on sufficient evidence, found that a reserve of the nature required was maintained, ample in amount to fulfill all insurance contracts, and that it was maintained in accordance with the requirements of the law of Arizona. We cannot see the applicability of the case cited.

In the case of *First National Benefit Society v. Stewart*, 152 Fed. 2d 298, which was similar in nature to the previous cited case, this court said:

“Appellee denied that appellant was a life insurance company within the meaning of Section 201 (a). On this issue, appellant had the burden of proof. Thus appellant had the burden of proving that it was engaged in the business of issuing life insurance and annuity contracts, and that its reserve funds held for the fulfillment of such contracts comprised more than 50% of its total reserve funds. The burden was not sustained.”

In other words, the sole matter determined by this court in the case last cited was that the appellant did not sustain the burden imposed on it of showing that its reserve funds held for the “fulfillment” of its life insurance and annuity contracts, comprised more than 50% of its reserve funds. In the present case, this burden was successfully maintained, as found by the Tax Court. We have examined all of the cases cited in petitioner’s brief and we have been unable to find any holding that a reserve of the type maintained by respondent in the present case, is insufficient to fulfill the requirements of Sections 201 and 202 *supra*, or the regulations adopted under them.

While some of the points raised in this case by petitioner were not expressly raised and decided in *Reliance Benefit Association v. Com.* 2 T.C. 15, yet the only reasonable implication from the decision of the Tax Court in this case is that it considered that case as sustaining the position of respondent that the reserve maintained by it qualifies under Sections 201 and 202, *supra*. The statute and regulations quite properly require that insurance companies set up sufficient re-

serves to guarantee that they will live up to their contracts, but it is a harsh, unreasonable and unjustified construction of the statute and regulations to say that the reserve fund maintained by respondent, which unquestionably sufficiently guarantees the fulfillment of all its insurance contracts, is not within the statute.

Counsel for petitioner has quoted approvingly and at length from the case of *General Life Insurance Company v. Commissioner of Internal Revenue*, 137 Fed. 2d, 185. We quote from the same case:

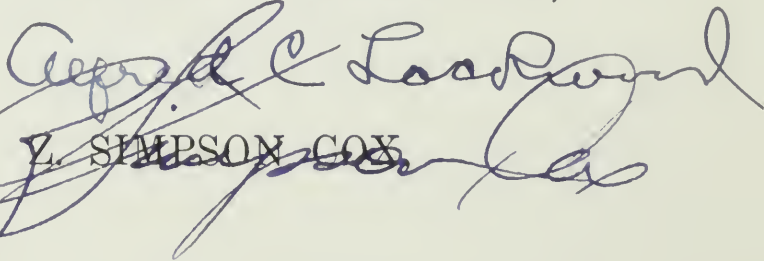
"It is hardly conceivable that the policy of Congress was to exempt large, old line, fixed-premium life insurance companies, with its risks variedly spread over wide areas, and which had large reserves maintained by interest earnings, from taxation of premium income and to deny the benefit of the exemption to younger, smaller, and weaker life insurance companies, with their risks largely localized, and which had not yet built up a reserve sufficiently large for the investment income to maintain the reserve in the event of serious local epidemics or disasters. To so hold would be to attribute to Congress a misdirected discrimination in favor of the strong over the weak. To give effect to Treasury Department Regulation No. 94, as construed and applied by the Commissioner, would tend to deny the benefits of the exemption to the companies that needed it most. It is not thought that this was the intention of Congress."

In the present case, to hold that a reserve maintained in strict accordance with the laws of the State of Arizona, and admittedly always actuarially sufficient to protect the "fulfillment" of its insurance contracts under a reasonable construction of what "fulfillment" requires, was insufficient to qualify respondent as an insurance company under Sections 201 and 202, *supra*,

would certainly tend to deny the benefits of the tax exemption granted by Sections 201 and 202, supra, to one of the companies which needed it the most. We submit that the judgment of the Tax Court should be affirmed.

Respectfully submitted,

ALFRED C. LOCKWOOD,



A handwritten signature in blue ink, appearing to read 'Alfred C. Lockwood', written over the printed name.

L. SIMPSON COX

LORNA E. LOCKWOOD,

L. J. COX, Jr.

Attorneys for Respondents.

IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

v.

NATIONAL RESERVE INSURANCE COMPANY, *Respondent.*

On Petition for Review of the Decision of the Tax Court
of the United States.

AMICUS CURIAE BRIEF OF THE TEXAS ASSOCIA-
TION OF MUTUAL LIFE INSURANCE OFFICIALS.

FILED

MAR 7 - 1947

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PAUL P. O'BRIEN,
CLERK

TABLE OF CONTENTS

	Page
Interest of Amicus Curiae	1
Argument	2
Conclusion	6

TABLE OF CASES

Bedford, Edward T., 39 B.T.A. 1039.....	4
Chicago Graphic Arts Federation Inc., Commissioner v., (C. C. A. 7) 128 F. (2d) 424, 29 A. F. T. R. 524..	4
Inter-Mountain Life Insurance Company, Helvering v., 294 U. S. 686, 15 A. F. T. R. 280.....	5
Koon Kreek Klub v. Thomas, (C. C. A. 5) 108 F. (2d) 616, 24 A. F. T. R. 58.....	4
New York Life Insurance Company v. Bowers, 283 U. S. 242, 9 A. F. T. R. 1425.....	5
Trinidad v. Sagrada Orden etc., 263 U. S. 578, 4 A. F. T. R. 3802	3
Y. M. C. A. Retirement Fund, Inc., 18 B. T. A. 139, 145.	4

OTHER AUTHORITIES

Reg. 111, Sec. 29.201-4	6
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No. 11417

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

NATIONAL RESERVE INSURANCE COMPANY, *Respondent*.

On Petition for Review of the Decision of the Tax Court
of the United States.

**AMICUS CURIAE BRIEF OF THE TEXAS ASSOCIA-
TION OF MUTUAL LIFE INSURANCE OFFICIALS.**

INTEREST OF AMICUS CURIAE.

The Texas Association of Mutual Life Insurance Officials is an association of officials of assessment life insurance companies operating in Texas. Such companies have approximately two million policyholders. In many instances the insurance carried by the members of the Texas assessment life insurance companies is the only life insurance carried by the members. If the assessment life insurance com-

panies are not taxed as “life insurance companies” under the Internal Revenue Code they cannot hope to survive in competition with companies taxed as “life insurance companies”. In that event the probabilities are that a great many of the persons insured in assessment life insurance companies will not be able, because of age or health, to secure insurance from other companies. It is obvious, therefore, that the importance of the case at bar extends far beyond the interest of the particular company involved in this litigation. Consequently, the Texas Association of Mutual Life Insurance Officials desires to present its views.

In Texas, assessment life insurance companies are required to pay at least sixty percent of their assessment income, exclusive of membership fees, into a mortuary fund held for the payment of policy claims. The Board of Insurance Commissioners permits payments out of the mortuary fund “of all attorneys’ fees and necessary expenses arising out of the defense, settlement, or payment of contested claims”.

Our concern is occasioned by the dissenting opinion in the case at bar because if its reasoning is adopted by this Court, it may throw a cloud over the tax status of Texas assessment life insurance companies which pay incidental contested claim expenses out of mortuary funds.

ARGUMENT.

The Government argues that this company should be denied the status of a “life insurance” company because its reserve funds are not held exclusively for the fulfillment of life insurance and annuity contracts. The Government admits that the statute does not specifically state that the reserve must be held “exclusively” for the fulfillment of such contracts, but that “this is its only reasonable interpretation”. (Br. 12)

Even if the statute provided, as it does not, that the reserve funds must be held exclusively for the fulfillment of policy contracts, the Tax Court decision would be correct.

The record in the case clearly shows that the reserve or mortuary fund was used for the following purposes:

1. Payment of policy claims.
2. Payment of refunds to policyholders of amounts collected in excess of amounts required to protect policyholders.
3. Payment of attorney's fees and other expenses incidental to the settlement of policy claims. Such expenses "were not excessive". (R. 28)
4. Minor items totalling \$34.99 in 1939 and \$47.03 in 1940 were erroneously charged to the mortality fund. (R. 28)
5. In addition, the by-laws of the taxpayer provide that a portion of the *savings* in the reserve fund may be set aside by the Board of Directors for the purpose of organizing a legal reserve life insurance company for the benefit of the taxpayer's members. (R. 102)

After the payments enumerated above the mortality reserve exceeded the reserve required by the Corporation Commission to protect policyholders. (R. 28)

The word "exclusively" has been the basis of tax litigation and its meaning in taxation is thoroughly established. Thus, in *Trinidad v. Sagrada Orden etc.*¹ a religious order claimed exemption from taxation as a corporation "organized and operated exclusively for religious, charitable * * * or educational purposes * * *". The Order had large properties consisting of real estate, stocks in private corporations, and money loaned at interest. Income from such properties, plus income from the sale of wine, chocolate and other articles, and income from other sources, amounted to 254,702.69 pesos in the year involved. The Government contended the religious order was not operated "exclusively" for religious purposes, but it operated also for busi-

¹ 263 U. S. 578, 4 A. F. T. R. 3802.

ness and commercial purposes in that it used its properties to produce income and traded in wine, chocolate and other articles. The Supreme Court held (p. 582):

“In using the properties to produce the income, it therefore is adhering to and advancing those purposes.”

Later, the Supreme Court states:

“Our conclusion is that the plaintiff is organized and operated exclusively for religious, charitable and educational purposes within the meaning of the excepting clause.”

The Board of Tax Appeals has stated the rule as follows:²

“In determining whether property is exempt as ‘used exclusively’ for certain purposes, the decisions have uniformly held that such language means the primary and inherent use and does not preclude such incidental uses as are directly connected with, essential to, and in furtherance of, the primary use.”

See also: *Edward T. Bedford*³; *Koon Kreek Klub v. Thomas*,⁴ and *Commissioner v. Chicago Graphic Arts Federation Inc.*⁵

The reasoning of the dissenting opinion in the case at bar may be erroneous for another reason.

In the case at bar, the following factual situation exists:

1. The state statute requires that a mortuary or reserve fund be created out of which may be paid all benefit claims arising under the certificate of membership plus the expenses incident to contested claims. (R. 24)

² Y. M. C. A. Retirement Fund, Inc., 18 B. T. A. 139, 145.

³ 39 B. T. A. 1039.

⁴ (C. C. A. 5) 108 F. (2d) 616, 24 A. F. T. R. 58.

⁵ (C. C. A. 7) 128 F. (2d) 424, 29 A. F. T. R. 524.

2. Except for the first year the Corporation Commission required that not less than 50 percent of the premiums be placed in the mortality reserve fund. That amount was deemed sufficient to enable the reserve fund to meet all the requirements of the American Standard Mortality Table on the basis of $3\frac{1}{2}\%$ interest accretions. (R. 26)

3. The taxpayer was required by the Corporation Commission to make refunds to policyholders of savings in the Death Benefit or Mortality Funds. (R. 27)

4. The taxpayer's reserve or mortality fund after refunding the savings to policyholders was in excess of the reserve required by the Commission to protect policyholders. (R. 28)

In *New York Life Insurance Company v. Bowers*,⁶ the Supreme Court was squarely confronted with the question of whether "dividends" or insurance savings were properly part of the life insurance reserves or merely surplus or contingent reserves maintained for the general use of the business. The Supreme Court states (p. 245):

"The sums to be paid as dividends are not a part of the insurance specified in the policies. They are derived from amounts which, from abundant caution, are included in the advance premiums over and above what is found by actual experience to be necessary to pay the cost of the insurance and the expenses of carrying on the business. They indicate a 'surplus' i.e., assets in excess of what is deemed necessary to provide for the payment when due of the amounts specifically covered by the policies."

In *Helvering v. Inter-Mountain Life Insurance Company*⁷ the Supreme Court reiterated its understanding of the term "reserve" as follows (p. 690):

⁶ 283 U. S. 242, 9 A. F. T. R. 1425.

⁷ 294 U. S. 686, 15 A. F. T. R. 280.

“In life insurance the reserve means the amount accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. * * * Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency * * *.”

Treasury Regulations recognize the rule as expressed above, as follows:⁸

“* * * Life insurance reserves do not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue * * * nor do they include * * * liability for annual and deferred dividends declared or apportioned * * *.”

In the case at bar, it is obvious that neither the company nor the Corporation Commission expected the excess premiums or assessments to remain in the mortality fund. It was anticipated that the excess would be refunded or used for the benefit of policyholders. Consequently, such excess was never legally a part of the mortality fund from a Federal tax viewpoint. That being true, the premium refunds and other disbursements have no effect on the “exclusive” use of the fund to pay mortality claims.

CONCLUSION.

The decision of the Tax Court is correct. It should be affirmed.

ROBERT ASH,
Munsey Building,
Washington, D. C.
*Attorney for Texas Association
of Mutual Life Insurance
Officials, Amicus Curiae.*

February, 1947.

⁸ Reg. III, Sec. 29.201-4.

No. 11417

In the
United States
Circuit Court of Appeals
For the Ninth Circuit

Commissioner of Internal Revenue,	}
<i>Petitioner,</i>	
vs.	
National Reserve Insurance Company,	
<i>Respondent.</i>	}

APPLICATION FOR LEAVE TO APPEAR
AS AMICUS CURIAE
AND
BRIEF OF AMICUS CURIAE TENDERED
WITH SUCH APPLICATION

FILED

MAR 19 1947

AUL P. O'BRIEN,

CLERK

ALLAN K. PERRY,
309 First National Bank Bldg.,
Phoenix, Arizona,

Applicant.

TOPICAL INDEX

	Page
Application for leave to appear as <i>amicus curiae</i>	1
Brief of <i>amicus curiae</i>	3
I. Summary of Argument	3
II. Argument	4
1. The character of the business in which the taxpayer was engaged during the taxable years is determinative of its classification for income tax purposes.....	4
2. Taxpayer was engaged in the life insurance business during the taxable years 1939 and 1940, within the meaning of the applicable sections of the Revenue Code.....	5
3. It was never the intent of the Congress to tax the premium income of a life insurance company or any part thereof.....	18
Conclusion	19

TABLE OF CASES AND AUTHORITIES CITED

	Page
Cases	
Bowers v. Lawyers Mortgage Company, 285 U. S. 182, 52 S. Ct. 350, 76 L. Ed. 690.....	4
Clarke v. Clarke, 178 U. S. 186, 26 S. Ct. 873, 44 L. Ed. 1028.....	9
Collins v. City of Phoenix, (C. C. A. 9), 26 F. 2d 753	10
Collins v. Streitz, (C. C. A. 9), 95 F. 2d 430.....	10
Commissioner v. W. H. Luquire Burial Ass'n, 102 F. 2d 89	4
Helvering v. Oregon Mutual Life Ins. Co., 311 U. S. 267, 85 L. Ed. 180.....	18
Lamana-Panno-Fallo Industrial Insurance Co. v. Commissioner, 127 F. 2d 56.....	11
Madden v. Commonwealth of Kentucky, 309 U. S. 83, 60 S. Ct. 406, 84 L. Ed. 590, 125 A. L. R. 1383.....	9
Pioneer Mutual Benefit Assn. v. Ariz. Corporation Commission, 59 Ariz. 112, 123 P. 2d 828.....	6
Reliance Benefit Association v. Commissioner, 2 T. C. 15, (143 F. 2d 597).....	10
St. Louis Southwestern R. Co. v. Arkansas, 235 U. S. 350, 35 S. Ct. 99, 59 L. Ed. 265.....	9
Storaasli v. Minnesota, 283 U. S. 57, 51 S. Ct. 354, 75 L. Ed. 839.....	10
U. S. v. Phellis, 257 U. S. 156, 168, 66 L. Ed. 180, 182, 42 S. Ct. 63.....	4

	Page
Van Dyke v. Parker, (C. C. A. 9), 83 F. 2d 35.....	10
Webster v. Cooper, 55 U. S. 488, 14 How. 488, 14 L. Ed. 510.....	10
Weiss v. Stearns, 265 U. S. 242, 254, 68 L. Ed. 1001, 1005, 33 A. L. R. 520, 44 S. Ct. 490.....	4

Statutes

Arizona Code, 1939, Sections 53-601, et seq.....	5
Arizona Laws of 1943, Chapter 95.....	19, 20

In the
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vs.

National Reserve Insurance Company,
Respondent.

No. 11417

APPLICATION FOR LEAVE TO APPEAR
AS AMICUS CURIAE

*To the Honorable, the United States Circuit Court of
Appeals for the Ninth Circuit:*

The application of Allan K. Perry, praying leave to appear as *amicus curiae* in the above numbered and entitled matter, respectfully represents and shows:

1. Applicant is a member of the bar of this court; his address is 309 First National Bank Building, Phoenix, Arizona, and he is counsel for National Union Insurance Company, Postal Benefit Insurance Company, and Empire Mutual Insurance Company (each of

whom is a benefit insurance company, organized and existing under the laws of the State of Arizona) the interests of each of whom may be affected directly or indirectly by the decision of this court in the matter here upon review.

2. As will be disclosed by the brief tendered herewith, applicant desires to urge before this court that the decision of the Tax Court of the United States (6 T. C. 473), now before this court for review, should be affirmed, and that the brief herewith tendered may be of assistance to the court in arriving at a correct determination of the questions presented by the parties to this proceeding.

WHEREFORE, applicant prays that he be permitted to appear herein as *amicus curiae* and file, for the consideration of the court, the brief tendered herewith.

Respectfully submitted,

ALLAN K. PERRY,
Applicant.

In the
United States
Circuit Court of Appeals
For the Ninth Circuit

Commissioner of Internal Revenue,	}	No. 11417
<i>Petitioner,</i>		
vs.		
National Reserve Insurance Company,		
<i>Respondent.</i>		

BRIEF OF AMICUS CURIAE

I. SUMMARY OF ARGUMENT

1. The character of the business in which the taxpayer was engaged during the taxable years is determinative of its classification for income tax purposes.

2. Taxpayer was engaged in the life insurance business during the taxable years 1939 and 1940, within the meaning of the applicable sections of the Revenue Code.

3. It was never the intent of the Congress to tax the premium income of a life insurance company or any part thereof.

whom is a benefit insurance company, organized and existing under the laws of the State of Arizona) the interests of each of whom may be affected directly or indirectly by the decision of this court in the matter here upon review.

2. As will be disclosed by the brief tendered herewith, applicant desires to urge before this court that the decision of the Tax Court of the United States (6 T. C. 473), now before this court for review, should be affirmed, and that the brief herewith tendered may be of assistance to the court in arriving at a correct determination of the questions presented by the parties to this proceeding.

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Respectfully submitted,

ALLAN K. PERRY,
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BRIEF OF AMICUS CURIAE

I. SUMMARY OF ARGUMENT

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3. It was never the intent of the Congress to tax the premium income of a life insurance company or any part thereof.

II. ARGUMENT

1. The Character of the Business in Which the Taxpayer was Engaged During the Taxable Years Is Determinative of Its Classification for Income Tax Purposes.

In *Bowers v. Lawyers Mortgage Company*, 285 U. S. 182, 52 S. Ct. 350, 76 L. Ed. 690, the United States Supreme Court said:

“While name, charter powers, and subjection to state insurance laws have significance as to the business which a corporation is authorized and intends to carry on, the character of the business actually done in the tax years determines whether it was taxable as an insurance company. *United States v. Phellis*, 257 U. S. 156, 168, 66 L. ed. 180, 182, 42 S. Ct. 63; *Weiss v. Stearns*, 265 U. S. 242, 254, 68 L. ed. 1001, 1005, 33 A. L. R. 520, 44 S. Ct. 490.”

In *Commissioner v. W. H. Luquire Burial Ass’n*, 102 F. 2d 89, the Circuit Court of Appeals for the Fifth Circuit employed this language:

“The authorities are almost unanimous in their holding that associations or companies of the character of this taxpayer are engaged in the life insurance business. Contracts such as the one issued by the Luquire Company are contracts of insurance and subject to control under the insurance statutes. 1 *Couch on Insurance*, Sec. 32; *Benevolent Burial Ass’n v. Harrison*, 181 Ga. 230, 181 S. E. 829; *State v. Mutual Mortuary Ass’n*, 166 Tenn. 260, 61 S. W. 2d 664; *State v. DeWitt C.*

Jones Co., 108 Fla. 613, 147 So. 230; *South Georgia Funeral Homes v. Harrison*, 182 Ga. 60, 184 S. E. 875; *Fikes v. State*, 87 Miss. 251, 39 So. 783; *Renschler v. State ex rel.*, 90 Ohio St. 363, 107 N. E. 758, L. R. A. 1915D, 501, Ann. Cas. 1916C, 1014; *State of Indiana v. Willett*, 171 Ind. 296, 86 N. E. 68, 23 L. R. A., N. S., 197; *Oklahoma Southwestern Burial Ass'n v. State*, 135 Okl. 151, 274 P. 642, 63 A. L. R. 704; Annotation, 63 A. L. R. 723; Annotation, 100 A. L. R. 1453. See, also, *State v. Brown Service Funeral Co.*, 236 Ala. 249, 182 So. 18."

In the instant matter, it seems to be conceded by both parties and found as a fact by the Tax Court that the respondent, during the taxable years here involved, operated under the *Arizona Benefit Corporation Law of 1937* (Sections 53-601, *et seq.* A. C. 1939) and that its business consisted of the issuance of policies of insurance upon the lives of its members.

It is submitted that the real test of the character of the business of the respondent is not the law under which it was incorporated, but the actual business transacted by it, under such law.

2. Taxpayer was Engaged in the Life Insurance Business During the Taxable Years 1939 and 1940, Within the Meaning of the Applicable Sections of the Revenue Code.

It is believed that a careful analysis of the Arizona statutes (Sections 53-601, *et seq.* A. C. 1939, set forth upon pages 39 to 44 of the petitioner's brief herein) will demonstrate that the "benefit corporations" oper-

ating thereunder are, in reality, mutual life insurance companies, without capital or surplus, but required to maintain, and who did maintain, mortuary reserves for the fulfillment of their policy obligations.

The Arizona Supreme Court in *Pioneer Mutual Benefit Association v. Arizona Corporation Commission*, 59 Ariz. 112, 123 P. 2d 828, has definitely determined that the creation and maintenance of policy reserves by companies operating under the *Benefit Insurance Law of 1937* is mandatory. In that case the court said:

“A consideration of the Benefit Corporation Law of 1937, in its entirety, its nature and purpose, leads to the conclusion that the legislative intent was to impose upon all benefit corporations, organized under it, the duty of stating in each benefit certificate issued by it the proportion of each payment made therefore, periodic as well as original, that would be set aside to the mortuary and reserve fund. This appears clearly from section 53-606, subdivision (2), which makes this definite statement: ‘(a) Every benefit certificate issued by any such corporation shall specify the maximum amount not exceeding five thousand dollars (\$5,000), on the life of any individual, to be paid on the happening of the contingency therein stated, *and shall state the basis or amount to be set aside to the mortuary and reserve fund. . . .*’ (Italics ours.) The requirements that such a statement be incorporated in all benefit certificates automatically creates a mortuary or reserve fund, because the legislature certainly did not impose this duty on a benefit corporation and then per-

mit it to set aside the amount named to that fund provided it saw fit to do so. To say the legislature meant this would be to charge it with requiring a useless, futile act, one, in fact rendering it possible for a corporation organized under this law to mislead or deceive by making it appear to the purchaser of the certificate, and others who might read it, that a sufficient portion of the amount paid in by the purchaser would be set aside to pay benefit claims and general operating expenses as stipulated therein, when in fact it was merely discretionary with the corporation whether it did this. Other provisions of the Benefit Law of 1937, strengthen the view that it requires the creation of a mortuary and reserve fund. . . . While it is true all dues or premiums are paid in for the purpose, among others, of taking care of benefit claims later on, yet, unless a certain portion of them is set aside to a special fund for that purpose, for instance, a mortuary fund, it is very questionable that they would be exempt from attachment. This thought is suggested by section 53-605 which requires the corporation to deposit with the state treasurer \$1,000 before the corporation commission may issue it a certificate to transact business, a sum that must be later increased to \$10,000, yet under subdivision (d) of this section, reading as follows, this entire amount is subject to execution: '(d) Any unsettled final judgment of a court of this state shall be a lien on the deposits of money or securities prescribed by section 608b (Par. 53-605), and subject to execution after thirty (30) days from entry of final judgment. If said deposit is depleted thereby it shall be replenished within ninety (90)

days.' Section 53-610, A. C. A. 1939, provides as follows: 'At least once in every two (2) years the corporation commission shall require the books and the affairs of each benefit corporation to be examined and audited by an accountant designated and commissioned by it, for the purpose of verifying the funds as provided in the benefit certificate thereof. . . . ' There are but two funds provided for in the Benefit Corporation Law of 1937, one the deposit required to be made with the state treasurer just mentioned, and the other the mortuary and reserve fund. If a benefit corporation may or may not, at its option, create and maintain a mortuary and reserve fund, there would, in case it decided not to create and maintain such a fund, be but one fund, to-wit, the one deposited with the state treasurer, and in such instance there would be no 'funds as provided in the benefit certificate thereof,' to be verified by an examination.

"The word 'may' according to the authorities, is read 'shall' or 'must' when used in the statute to impose a duty, the performance of which involves the protection of public or private interests. . . .

"The legislature has, in the Benefit Corporation Law, imposed upon the corporation commission the duty of seeing to it that the premiums paid for benefit certificates (insurance policies) are sufficient to pay benefit claims. If in its judgment the premiums proposed in any certificate submitted to it for approval are not sufficient for this purpose, it would be its duty to refuse to authorize the corporation to solicit applications therefor, unless the corporation should not only

make the premiums sufficient for this purpose, but also state in the certificate what percentage thereof it is setting aside to the mortuary and reserve fund and it should appear to the commission that the amount set aside is high enough to take care of the benefit claims that might arise under it. If the commission should require a larger premium than necessary or that a greater proportion of those paid be set aside to the mortuary fund than the payment of benefit claims and general operating expenses would demand, the corporation could, in a proper action, have the commission lower it to the proper amount. But, as we see it, the legislature has placed in the jurisdiction of the corporation commission, a disinterested body to whose management the law has committed the insurance department of the state, complete power to see that benefit corporations, organized under the law of 1937, pay proper premiums and create out of them a mortuary and reserve fund large enough to take care of the benefit claims and general operating expenses arising thereunder."

Of course, the United States courts are bound by the interpretation of a state statute by the highest jurisdictional tribunal of the state.

Madden v. Commonwealth of Kentucky, 309 U. S. 83, 60 S. Ct. 406, 84 L. Ed. 590, 125 A. L. R. 1383;

Clarke v. Clarke, 178 U. S. 186, 26 S. Ct. 873, 44 L. Ed. 1028;

St. Louis Southwestern R. Co. v. Arkansas, 235 U. S. 350, 35 S. Ct. 99, 59 L. Ed. 265;

Storaasli v. Minnesota, 283 U. S. 57, 51 S. Ct. 354, 75 L. Ed. 839;

Webster v. Cooper, 55 U. S. 488, 14 How. 488, 14 L. Ed. 510;

Collins v. Streitz, (C. C. A. 9) 95 F. 2d 430;

Van Dyke v. Parker (C. C. A. 9) 83 F. 2d 35;

Collins v. City of Phoenix (C. C. A. 9) 26 F. 2d 753.

In *Reliance Benefit Association v. Commissioner*, 2 T. C. 15 (review dismissed, 143 F. 2d 597) the Tax Court said:

“In discharging its duties under the Benefit Corporation Law of 1937 the state corporation commission required that reserves created by benefit corporations be calculated upon the basis of the American Experience Table of Mortality, with $3\frac{1}{2}$ per cent accretions, or the approximate equivalent thereof. Consequently, it has approved the use of policies providing for reserves computed upon recognized mortality tables and assumed rates of interest, as well as policies providing for a reserve of at least 50 per cent of all premiums after the first year from date of issuance, if the premiums under the latter type of policies are sufficient that a reserve so computed will be substantially equivalent to one based upon accepted mortality tables. In order to determine whether the rates of premiums are sufficient for this purpose, the commission has referred all policies, prior to their approval, to an insurance actuary; and the commission has approved policies which, according to the actuary's report, proposed a reserve fund equivalent to one based upon the American

Experience Table of Mortality, with $3\frac{1}{2}$ per cent accretions. . . .

“Since, in the instant case, petitioner was required by law to maintain a reserve equivalent to a reserve computed upon the American Experience Table of Mortality, with an assumed rate of interest, and since of its total reserves more than 50 per cent were held for the fulfillment of its life insurance policies, we hold that petitioner is a life insurance company within the meaning of section 201 (a) of the Revenue Acts of 1936 and 1938.”

The Circuit Court of Appeals for the Fifth Circuit, in *Lamana-Panno-Fallo Industrial Ins. Co. v. Commissioner*, 127 F. 2d 56, discussed the question there presented as to whether the taxpayer was a “life insurance company” within the meaning of the 1936 Revenue Act and reached the following conclusion:

“We are of opinion that the Revenue Act, and Regulation 94 construing it, do not concern themselves with the sufficiency, but only with the character of the reserves of insurance companies. It is not the function of the Commissioner to review the decision of the State insurance department as to the sufficiency of the reserves or the solvency of the company. There is no federal policy to tax discriminatorily a life insurance company whose reserves may be deficient or depleted. Life insurance companies as a class are favored, particularly in Section 203 of the Act which allows a deduction from gross income of ‘an amount equal to 4 per centum of the mean of *the reserve funds required by law* and held at the beginning and end

of the taxable year.' If the law, meaning the State law, requires assets to be tied up in a reserve for policies, this deduction of four per cent is allowed, probably, to offset a loss of interest by reason of the character of investment usually required for reserves. If the reserve required by the State is one hundred per cent of the full actuarial reserve, a greater deduction from gross income is obtainable than when only fifty per cent is required. The tax officer is bound to see that the deduction claimed is based on reserves 'required by law,' as contrasted with voluntary reserves sought to be used as a basis of deduction. He is also concerned to examine the reserves under Section 201 to be sure the taxpayer is a life insurance company at all, for that Section defines a life insurance company as one whose reserve funds held for the fulfillment of its life insurance and annuity contracts comprise more than 50 per centum of its total reserve funds. The company, if doing other business than life insurance and annuity, and setting up reserves for this other business, must have the major portion of its reserves held for its life insurance and annuity contracts, in order to be taxed as a life insurance company. The Regulation, Art. 201, very reasonably imports from Section 203 the qualification 'required by law', so that a voluntary increase in those reserves cannot be used to make into a life insurance company a company which otherwise would not be such. The Regulation in Art. 203(a) (2)-1 is careful to exclude all things from the reserve 'not required by express statutory provisions or by rules and regulations of the insurance

department of a State', and provides that 'a company is permitted to make use of the highest aggregate reserve called for by any State . . . in which it transacts business, but the reserve must have been actually held.' We find no provision in Statute or Regulation looking to a demand on the Commissioner's part for larger reserves than the State has required.

"The reserves here set up are required to exist by State statute, but the amount to be set apart is not expressly fixed. The statutes require the Secretary of State as Insurance Commissioner to be furnished annually the details of its business by each life insurance company, and that he cause the policies to be valued, and ascertain 'the reinsurance reverse' and 'surplus' on a stated actuarial basis, and no company can issue policies until it is found to have complied with the laws of the State and is given a certificate to that effect. Act 114 Louisiana Laws 1898. Other provisions touching reserves occur in Act 148 Louisiana Laws 1936, but there is no express requirement that one hundred per cent of the actuarial reserve be set apart. Yet the purpose to have the policies protected by a reserve is evident, and the 'surplus' of the company can be estimated only after ascertaining and deducting from assets full reserves. The laws certainly authorize the Secretary to require what he thinks are adequate reserves to be set apart, and an announced and enforced requirement on his part which is applicable to petitioner and all like insurance companies for the tax year establishes a 'reserve required by law' within the meaning of the Statute and Regulation. It ought to be so recognized.

“We are asked to review and overrule our decision in *Commissioner v. W. H. Luquire Burial Ass’n*, 5 cir., 102 F. 2d 89, that contracts for burial benefits at death are a form of life insurance; since it appears that petitioner’s insurance contracts were in an undisclosed amount of that sort. We are assured that the burial benefits contracts all had a cash measure of some sort, as they did in the Luquire case. We see no reason to doubt our former conclusion that they are a form of insurance against death.”

But, if this *amicus curiae* correctly interprets the position of the Commissioner in the matter now at bar, it appears that he, the Commissioner, seek to distinguish the instant cause from the reported decisions upon the following grounds:

(a) The Arizona statutes permit and direct that a portion of the mortuary (reserve) fund be deposited with the State Treasurer and that a judgment against the company can be collected out of such deposit.

(b) Such statutes permit the use of the mortuary, or reserve, fund to pay attorney’s fees and incidental expenses incurred in the defense of disputed claims.

(c) The “mortality savings” or the surplus in the mortuary fund over and above the reserves required by law could be, under the by-laws of the respondent, returned to the insured members in the form of dividends applied to the purchase of stock in a contemplated capital stock life insurance corporation.

If the Commissioner is correct in his contention (under the foregoing paragraph "c"), then it is submitted that every mutual life insurance company, from the oldest and strongest to the youngest and weakest, is forbidden *by the revenue statutes* from distributing its mortality savings in the form of dividends to its policyholders; and the entire amount originally collected for reserve purposes must be applied to the payment of policy claims exclusively, so that a reserve of several thousand per cent of that lawfully required for the fulfillment of life insurance contracts must be created or the company pay income tax on that portion of its premium receipts going into the creation of such reserves. It is submitted no such ridiculous and disastrous result was ever intended by the Congress.

Everything that the Commissioner says in his brief, with respect to the little items of attorney's fees, telephone tolls, etc., in connection with the settlement of claims, is ably answered by the majority Tax Court opinion in this cause, 6 T. C. 473, thus:

"Petitioner was a nonstock, nonprofit, mutual corporation and the savings or excess premiums in its mortality fund belonged to its policyholders, Its mortality reserve was not impaired by the pro rata distributions to policyholders. At all times material hereto this reserve was in excess of legal requirements. The incidental expenses charged to the mortality reserve were properly charged thereto under state law and petitioner's by-law XVI. The ledger entries with respect to incidental expenses specifically referred to the policyholder

whose claim was being settled and the expense items charged to the fund were incidental to settlement of the claims payable under the policies. *The aggregate amount in each year was not excessive and did not impair the reserve fund required by law to protect its policyholders.* The minor items were frankly admitted by petitioner to be an improper charge against the mortality fund. It is urged, however, that these items were nominal in amount, did not affect the sufficiency of petitioner's reserve, and show that the ledger account was not kept in accordance with good book-keeping practices.

“Respondent argues strenuously that because of these charges the reserve funds held by petitioner were not true reserves as defined by section 201(a), since the reserve fund was subject to and was actually used to meet general operating expenses as well as policy claims. Respondent cites and relies upon *First National Benefit Society v. Stuart* (C. C. A., 9th Cir., 1943), 134 Fed. (2d) 438; certiorari denied, 320 U. S. 211; *First National Benefit Society v. Stuart* (D. C. 1944), unreported case, decided June 15, 1944, and section 19.203 (a) (2)-1 of Treasury Regulations 103. We do not understand that respondent denies the sufficiency in amount of petitioner's mortality reserve; his point is that, regardless of the amount set aside in the fund, it was not a reserve, since it could be and was invaded for ordinary operating expenses, and if a part of the fund is subject to such use the entire fund could be so used, which prevents the fund from being a ‘reserve fund’ within the meaning of section 201(a), *supra*.

“In considering the respondent’s argument it must be remembered that general operating expenses were payable out of the expense fund provided for by section 2, article XVI, of petitioner’s by-laws. His argument poses the question of whether the payment of minor items, which in no way impaired the reserve funds required for the protection of policyholders, and which were erroneously charged thereto, makes that reserve fund other than a reserve for benefit claims. We think not. To so hold would give book entries a probative weight to which such entries are not entitled, *Doyle v. Mitchell Bros. Co.*, 247 U. S. 179. *Petitioner’s assets available to satisfy policy claims and the mortality reserve exceeded mortality reserve requirements.* Bookkeeping errors or the use of this excess for business purposes should not defeat petitioner’s classification as a life insurance company where it otherwise meets the requirements of section 201.

“Respondent argues that we should construe the term ‘reserve funds’ in section 201(a) the same as the Treasury regulations construe that term in section 203(a) (2) of the code. In *Reliance Benefit Association*, *supra*, we assumed that the term ‘reserve funds’ was to be given the same meaning in both sections. On that point, among other things, we said: ‘The validity of such regulations (referring to the regulations on this point) has been recognized by this and other courts, *Swift & Co. Employees Benefit Association*, 47 B. T. A. 1011, and cases cited therein. . . .’

“But, while agreeing with the Commissioner in the *Reliance Benefit Association* case, *supra*, that

the term 'reserve funds' meant the same in both sections of the statute, we did not agree with him that the reserves there involved did not meet the test of the statute. We held that 'reserve funds' in that case, which were arrived at in all essential respects in the same way as in the instant case, qualified as true life insurance reserves within the purview of section 201 (a), and that the taxpayer there was taxable as a life insurance company. We so hold here." (Emphasis supplied.)

3. It was Never the Intent of the Congress to Tax the Premium Income of a Life Insurance Company or Any Part Thereof.

Prior to 1921, insurance companies had been taxed under the act of 1909 applying to corporations generally, but allowed a deduction of "the net addition if any required by law to be made within the year to reserve funds."

In 1921 a change was made in the general plan of taxation of insurance companies recognizing as a general principle that the collection of premiums for the purpose of paying expenses and losses is not true income but rather a contribution to capital. The special schedule for insurance companies under the Revenue Code provided for the taxation of life insurance companies *only on their investment income*.

The reasons for the change are set forth in *Helvering v. Oregon Mutual Life Insurance Company*, 311 U. S. 267, 85 L. Ed. 180, (affirming the decision of the

United States Circuit Court of Appeals for the Ninth Circuit, reported in 112 F. 2d 468) thus:

“Legislative history discloses that a deduction similar to that allowed by 203 (a) first appeared in the Revenue Act of 1921. . . .

“The new plan as it relates to Life Insurance Companies *had as its major objective the elimination of premium receipts from the field of taxable income.* It had long been pointed out to Congress that the receipts except as to a very minor proportion of each premium were not true income but were analogous to permanent capital investment.” (Emphasis supplied.)

The entire reserves of the taxpayer in the cause at bar were certainly created out of premium income, and it is submitted the Congress never intended to tax such reserve accumulations.

Nor can the Commissioner, by any rule or regulation, convert a “life insurance company” into a “mutual insurance company other than life,” when its entire business is that of insuring the lives of its members.

III. CONCLUSION

None of the benefit insurance companies regularly represented by this *amicus curiae* issues policies providing that the “mortality savings” may be used to create a fund for the establishment of a capital stock life insurance company. However, under the 1937 *Benefit Corporation Act of Arizona* (which has now been superseded by *Chapter 95 of the Arizona Laws of*

1943, entitled "*The Benefit Insurance Corporation Law of 1943*"—Sections 61-919 *et seq.* A. C. supplement) all Arizona benefit corporations were authorized to, and probably did, use some small portion of their respective mortality funds in the defense of claims believed unjust or unwarranted. Also, under a strict interpretation of the act, the portion of the mortuary fund deposited with the State Treasurer was subject to use in payment of judgments obtained by general creditors, as well as judgments obtained upon a policy of insurance. So far as is known to the author of this brief, not one cent of any such deposit with the State Treasurer was ever used for the payment of any judgment of a general creditor against an Arizona benefit corporation.

But, it is submitted that even though portions of the mortuary fund were used in the payment of legal expenses or even in the payment of a judgment obtained by a general creditor if there still remained a reserve of over fifty per cent for the payment of policy claims, no one can successfully argue that the company (writing only life insurance) was thereby converted from a "life insurance company" to a "mutual insurance company other than life or marine" within the meaning of the Revenue Code.

Respectfully submitted,

ALLAN K. PERRY,
Amicus Curiae.

No. 11418

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

LAWRENCE WAREHOUSE COMPANY, a corporation,
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
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Appellant,

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DEFENSE SUPPLIES CORPORATION,
Appellee.



And Others.

APPELLANT CAPITOL CHEVROLET
COMPANY'S OPENING BRIEF.

FILED

MAY 17 1947

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TOPICAL INDEX

	PAGE
Jurisdiction	1
Statement of the case.....	2
Specification of error upon which the appellant, Capitol Chevrolet Company intends to rely.....	8
Statutes involved	9

I (a).

There being no contractual relationship between plaintiff and ap- pellant the only basis for liability must be negligence.....	9
-----------------------------------------------------------------------------------------------------------------------------------	---

I (b).

There is no proof of negligence on the part of Capitol Chevrolet Company; Finding V has no substantial evidentiary support and is contrary to the evidence.....	10
-----------------------------------------------------------------------------------------------------------------------------------------------------------------------	----

I (c).

The plaintiff was guilty of contributory negligence.....	27
----------------------------------------------------------	----

II.

The court erred in the admission and exclusion of evidence. Proof of the price paid for the tires and tubes by the Govern- ment was inadmissible as evidence of the value of such articles for several reasons.....	29
1. The applicability of the hearsay rule will now be shown....	29
2. The court erred in receiving in evidence testimony based on documents purporting to show prices paid by plaintiff for the articles destroyed, because the sales were coerced and forced	34
Plaintiff's uncertainty as to following its own program adds to the conjectural character of its proof.....	38
Conflict between buying and selling prices.....	38
If damages are possible at all they could only be nominal damages under the evidence.....	39

3. When damages may be proved with approximate accuracy
they must be so proved..... 45

With reasonable industry and ordinary business acumen
the number of tires and their grades could have been
proved 50

III.

In respect to the number and value of the articles involved,
Finding II of the Finding of Fact has no support in the evi-
dence and is contrary to the evidence..... 53

Conclusion 65

TABLE OF AUTHORITIES CITED

CASES	PAGE
Allen v. Somers, 73 Conn. 355, 52 L. R. A. 106.....	28
American State Bk. v. Butts, 111 Wash. 612.....	33
Anthony v. New York etc. Co., 162 Mass. 60.....	33
Barnett Oil & Gas Co. v. New Martinsville Oil Co., 254 Fed. 481	43
Bartlesville Interurban Ry. Co. v. Quaid, 151 Pac. 891, L. R. A. 1918A	33
Borough of Melbourne, Appeal by, 329 Pa. 321, 198 Atl. 49.....	36
Brady v. Southern Co., 320 U. S. 476.....	27
Brown v. Hitchcock, 128 Vt. 452.....	28
Bullard v. Stone, 67 Cal. 477.....	36
Calahan v. Dunker, 51 Ind. App. 436.....	33
Carper v. Risdon, 19 Colo. App. 530.....	33
Chase v. City of Portland, 86 Me. 367.....	41
Clark v. Chicago, R. I. & Ry. Co., 186 Fed. 539.....	9
Clark v. Logan Mut. L. & B. Co., 58 Ill. App. 131.....	41
Colby v. Title Ins. & Trust Co., 160 Cal. 632.....	43
Con v. Tryon, 31 Pa. S. Ct. 146.....	33
Denver R. Co. v. Heckman, 45 Colo. 470.....	33
Dexter Portland Cement Co. v. Acme Supply Co., 133 S. E. 788, 147 Va. 758.....	55
Dolbeer, Estate of, 149 Cal. 573.....	32
Dudley v. Minn. etc. Co., 77 Ia. 408.....	33
Fay & Bates, 99 Mass. 263.....	28
Floyd v. Shenango Furnace Co., et al., 186 Fed. 505.....	9
Franklin v. May Department Store, 25 Fed. Supp. 735.....	21, 22
Galusha v. Sherman, 105 Wis. 263, 47 L. R. A. 417, 81 N. W. 495	43
Gibson v. Hatchett, 24 Ala. 201.....	28

	PAGE
Girard Tr. Co. v. Philadelphia, 248 Pa. 179.....	33
Hanover Water Co. v. Ashland Iron Co., 84 Pa. 279.....	33
Helvering v. New President Corp., 122 F. (2d) 92.....	41, 42
Holland v. Kelly, 74 Cal. App. 576.....	32
Hollinger v. Missouri etc. Ry. Co., 94 Kan. 316.....	36
Hollister v. Cordero, 76 Cal. 649.....	32
Hullhorst v. Sharner, 15 Neb. 57, 17 N. W. 259.....	43
Insurance Co. of N. America v. McGraw, 255 Ky. 839, 75 S. W. (2d) 518.....	36
John Mouat L. Co. v. Wilmore, 15 Colo. 136.....	36
Kelly v. Chicago, etc. Ry. Co., 122 Fed. 286.....	9
Kelly v. People's Nat. Ins. Co., 262 Ill. 158.....	33
Kelly v. Robinson et al., 262 Fed. 695.....	9
Knight v. Atlantic Coast L. R. Co., 73 F. (2d) 76.....	9
Lewis v. Englewood Elev. etc. Co., 223 Ill. 223.....	33
Little Rock Junction Ry. v. Woodruff, 49 Ark. 381, 4 Am. St. Rep. 51.....	41, 42
Lusardi v. Prukop, 116 Cal. App. 506.....	32
Macutis v. Cudahy Packing Co. et al., 203 Fed. 291.....	9
Madisonville, etc. R. Co. v. Ross, 126 Ky. 138, 13 L. R. A. (N. S.) 420.....	41
Mar Shee v. Maryland Assurance Co., 190 Cal. 1.....	32
Mauer v. Egan, 182 N. Y. Supp. 180.....	9
McNulty v. Lawley, 42 Cal. App. 747.....	33
Metropolitan Water Dist. v. Adams, 99 P. (2d) 659.....	41
Meyer v. Guardian Trust Co., 296 Fed. 789.....	43
Milwaukee & St. P. R. Co. v. Kellogg, 94 U. S. 469.....	27
Morrill v. Nightingale, 93 Cal. 452, 27 Am. St. Rep. 207, 28 Pac. 1068	43
Morrison v. Faulkener, 84 Tex. 128, 15 S. W. 797.....	43

	PAGE
Muser v. Magone, 155 U. S. 240, 39 L. Ed. 135.....	36
Northlake Ave., Re, 96 Wash. 344.....	33
Ogilvie v. Aetna L. Ins. Co., 189 Cal. 406.....	31
Oldenberg v. Oregon Sugar Co., 39 Ore. 564.....	33
Olson v. United States, 292 U. S. 246, 78 L. Ed. 1236.....	36
Packing Co. v. Sunland Sales, etc. Assn., 100 Cal. App. 126.....	36
Parker v. Union Ice & S. Co., 59 Kan. 626.....	28
People v. Schwartz, 78 Cal. App. 561.....	36
Pierce v. Patterson, 50 Cal. App. (2d) 486.....	31
Pitney, Appeal of, 20 N. J. Misc. 448, 28 Atl. (2d) 660.....	41, 42
Pittsburgh V. & C. Ry. Co. v. Vance, 115 Pa. 325.....	41
Putnam v. White, 88 So. 355.....	33
Ridley v. Seaboard etc. R. Co., 124 N. C. 37.....	33
River Park Dist. v. Brand, 327 Ill. 294, 158 N. E. 690.....	36
San Diego Land & Town Co. v. Neale, 78 Cal. 63, 3 L. R.	
A. 83	41
San Jose & A. R. Co. v. Mayne, 83 Cal. 566.....	33
Schultz v. Catlin, 78 Wis. 611, 47 N. W. 946.....	43
Scott v. O'Neil, 23 Ky. L. Rep. 331, 62 S. W. 1042.....	34
Shea v. Boston etc. R. Co., 217 Mass. 163.....	33
Shurtleff v. Marcus Land, etc., Co., 59 Cal. App. 520.....	36
Smith v. Frost, 51 Ga. 336.....	28
Southerland v. Albany, S. & W. Co., A. A. N. Y. Supp. 835....	28
Southern California Edison Co. v. Ind. Acc. Com., 96 Cal. App.	
337	36
Spring Valley Water Works v. Drinkhouse, 92 Cal. 528.....	45
St. Louis K. & A. Ry. Co. v. Chapman, 38 Kan. 307.....	41
Starrs v. Robinson, 74 Conn. 443.....	33
State ex rel. Highway Com. v. Stoddard Gin Co., 62 S. W.	
(2d) 940	36

	PAGE
Steinhauser v. Spraul, 127 Mo. 541, 27 L. R. A. 441.....	9
Thompson v. Niggley, 53 Kan. 664, 26 L. R. A. 803, 35 Pac. 290	43
Union Pacific etc. Ry. Co. v. Williams, 3 Colo. App. 526.....	36
Wagner & C. v. Dunham, 246 S. W. 1004.....	41
Wall v. United Gas etc. Co., 178 La. 908, 152 So. 561.....	37, 41
Willamet Falls C. & L. Co. v. Kelly, 3 Ore. 99.....	41
Wilson v. Southern Pacific R. R. Co., 62 Cal. 164.....	10
Yolo K. & P. Co. v. Edmonds, 50 Cal. App. 444.....	33

STATUTES

Civil Code, Sec. 1814	16, 23
Civil Code, Sec. 1858e.....	9
Civil Code, Sec. 3354.....	36
Code of Civil Procedure, Sec. 1926.....	32
Code of Civil Procedure, Sec. 2049.....	7
Code of Civil Procedure, Sec. 2055.....	7
Reconstruction Corporation Act, Sec. 5d (Act of Jan. 22, 1932, Chap. VIII, 47 Stats. at L. 5; 15 U. S. C. A., pars. 601-607)	2
United States Codes, Title 28, Secs. 41, 42, 225.....	1

TEXTBOOKS

20 American Law Reports, p. 97.....	9
49 American Law Reports, p. 521.....	9
99 American Law Reports, p. 408.....	9
10 California Jurisprudence, p. 1039.....	32
3 Corpus Juris Secundum, p. 134.....	9
25 Corpus Juris Secundum, p. 496.....	46
31 Corpus Juris Secundum, p. 919.....	30
31 Corpus Juris Secundum, p. 924.....	30
1 Greenleaf on Evidence (16th Ed.), pp. 183-185.....	30

	PAGE
2 Greenleaf on Evidence, 14th Ed., Sec. 301, note.....	43
Joyce, Defense to Commercial Paper, Sec. 105.....	43
Mechem on Agency, Secs. 569, 572, 573.....	9
5 Nichols' Applied Evidence, p. 4579.....	34
27 Ruling Case Law, p. 991.....	28
5 Wigmore on Evidence (3d Ed.), p. 27.....	30
5 Williston and Thompson on Contracts, p. 4512.....	43
26 Words & Phrases, pp. 565-575.....	36



No. 11418

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

LAWRENCE WAREHOUSE COMPANY, a corporation,
Appellant,

vs.

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Appellee.

CAPITOL CHEVROLET COMPANY, a corporation,
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

And Others.

**APPELLANT CAPITOL CHEVROLET
COMPANY'S OPENING BRIEF.**

*To: The Honorable Judge of the United States Circuit
Court of Appeals for the Ninth Circuit:*

Jurisdiction.

Jurisdiction is conferred by Sections 41 and 42 of Title 28, U. S. Codes and by Section 225, Title 28, U. S. Codes. The amount in controversy exceeds \$3,000 exclusive of interest and costs.

The plaintiff is the Defense Supplies Corporation, a Government Agency of the United States, organized under Section 5d of the Reconstruction Corporation Act (Act of January 22, 1932), Chapter VIII, 47 Stats. at L, p. 5, Title 15 U. S. C. A., paragraphs 601-607, as amended.

The defendant, Capitol Chevrolet Company, is a California corporation having its principal place of business in the City of Sacramento, State of California.

Following the rendition of the judgment by the District Court of the United States on April 15, 1946 [R. pp. 83, 84] notice of appeal was thereafter duly and regularly filed [R. pp. 90-96] by the various parties in the case.

Statement of the Case.

Lacking facilities to store tires being gathered under the War Program of collecting surplus tires, the Government of the United States organized the Idle Tire Act Program in the collection of surplus and extra tires of all kinds and character. Several small storage places were secured in the City of Sacramento, but it was desired to collect all of these tires in one place outside of the city. Acting through the Lawrence Warehouse Company, the Government located the "Ice Palace" outside of the City of Sacramento which had been used for a skating rink and which consisted of a large area on the Davis Highway in Sacramento, and which had a skating rink in the center. Adjoining the skating rink and connected with it was a small building having an engine room and a brine tank, a well being dismantled and fire hydrants at four corners of the building.

The Government inspected the building and selected it in the condition in which it appeared and entered into a

contract with the Lawrence Warehouse Company, by the terms of which the Lawrence Warehouse Company was to arrange for the storing of the tires under instructions from the Government.

With respect to certain important factual and legal issues this case has no direct precedents.

This results from the fact that prior to World War II exigencies had never arisen which required the commandeering by the Government of such articles as tires and tubes by the Government. Back of the present litigation, the trial and this appeal that circumstance is involved in the decisive issues.

The plaintiffs herein, Defense Supplies Corporation, is an agency which was created under the Reconstruction Finance Corporation Act to collect for the National Government the available automobile tires and tubes throughout the country. In 1943, plaintiffs formed and put into effect the "Idle Tire Purchase Plan", by which the sub-agencies were set up in each district or "area" one of which was the "area of Northern California."

Officers of Defense Supplies Corporation, (to be termed herein, "the corporation"), established an office in San Francisco for said area and sent out employees to locate buildings in which the tires and tubes to be acquired might be stored. Apparently this was being done while other details of the plan were being worked out.

During this period, John McKee was an agent of the Corporation, who was located at the San Francisco office, and Alfred D. McClellan, an "examiner", working under McKee, was supervising the "Idle Tire Program." [R. pp. 137, 138.]

A Mr. Baxter was a "field agent" of the corporation, one of whose functions was to make investigations with respect to available storage buildings for tires and tubes. In the performance of this duty he investigated the "Ice Palace" building near Sacramento. [R. p. 142.]

The "Ice Palace" was purchased by Clyde W. Henry and Charles Parella prior to March 1, 1943. [R. pp. 159, 181.]

On that date the corporation entered into a written lease agreement of the Ice Palace with the Lawrence Warehouse Company, as lessor, pursuant to a previously made "master contract" by which the Lawrence Company was to act in an intermediary capacity, contracting with the Corporation for leasing of certain buildings and releasing them to others through agency agreements. [R. pp. 109, 110.]

However, as early as October 1, 1942 the Lawrence Company had entered into an agreement, entitled "Agency Agreement with Government Custodian", with the Capitol Chevrolet Company for the storage of tires and tubes in the Ice Palace to be delivered by the Lawrence Company, as custodian for the plaintiff corporation. [R. p. 341.]

Prior to October 1, 1942, arrangements had been made by an employee of the corporation for the leasing of the Ice Palace by the Chevrolet Company and the corporation had authorized said company to lease the same and had approved of the agreement between the Lawrence and the

Chevrolet Companies before it was made, and had furnished the Lawrence Company with the form of the lease agreement which they signed. [R. pp. 110, 111.]

After March 1, 1942 and before April 9, 1943, tires and tubes were delivered at the Ice Palace warehouse by employees of the Corporation and on the last named date a fire started in the "engine room", which immediately adjoined the warehouse, which consumed the building and destroyed its entire contents. [R. 227-229, 345.]

It is important to note that arrangements had been made between the plaintiff corporation and the Lawrence Company by which the Corporation designated the Burns Detective Agency to be employed to guard the Ice Palace by a twenty-four hour a day lookout, for which services the Lawrence Company were to pay the Burns Agency and to be reimbursed by the corporation [R. 284-285]; also the corporation, soon after March 1, 1943, provided its watchmen and the Chevrolet Company with a list of persons who, only, might be permitted entrance to the warehouse and gave instructions that no property be permitted to be taken from the premises except upon approval of the Chevrolet Company.

The Ice Palace was occupied exclusively by the property of the Corporation. The operation was joint but the actual supervision and guarding of the property was had by agencies selected and actually paid by plaintiff.

The action, as tried, is for damages resulting from the destruction of tires and tubes alleged to have been burned in the fire.

During the trial plaintiff's witness McClellan admitted inability to prove the number of tires which were destroyed except by a letter from an official of the Chevrolet Company. The letter was not based upon the writer's personal knowledge. [R. p. 148.]

Also plaintiff's counsel stated that he could not prove the grades of the tires, except those classed as scrap, nor could he establish the market value of either tubes or tires, and that he would attempt to prove damages by showing the cost of the tires to the plaintiff for which he would show that OPA ceiling prices were paid.

In lieu of evidence to show the number of tires on storage of the various grades said counsel avowed that he would prove the entire number of tires of each grade purchased in the area of Northern California and establish the average percentage of tires in each grade and would ask that the tires destroyed in the Ice Palace be regarded as divided numerically according to such averages, for the purpose of determining their cost to plaintiff corporation. [R. pp. 117, 118, 121.]

Plaintiffs witness established that the OPA ceiling prices were fixed by the United States government; that the law did not permit owners of automobile tires or tubes to sell them except to it and compelled the owners to sell those which the Defense Corporation appraisers appraised and at the prices fixed by the appraiser.

To prove negligent omission to perform the alleged duty of appellant to safeguard the tires and tubes, the corpora-

tion's witness testified that the corporation itself, or through the Lawrence Warehouse Company, employed the Burns Detective Agency to maintain a twenty-four hour a day watch and lookout over the Ice Palace and premises [R. p. 284 *et seq.*], and that one of the watchmen was on duty when a man named McGrew, who had been admitted to enter the engine room to remove some equipment belonging to the Landlord, was using an acetylene torch of a highly dangerous character; that the watchman observed what was being done, but merely walked away, and within a few minutes the fire started and the warehouse was in flames. [R. pp. 293, 296.]

The plaintiff's own witness, McGrew, denied that his work started the fire. [R. pp. 220-225]. He attributed the fire to an unknown source; yet, the court, without any evidence to support it, found that his work started the fire. He was the plaintiff's own witness and the plaintiff was bound by his testimony, since no impeaching evidence was offered (C. C. P. Sec. 2049) and he was not called as an adverse witness under Section 2055 of the Code of Civil Procedure.

When the plaintiff rested its case, the defendants also rested and moved to dismiss the action, which motion, after being taken under advisement, was denied.

Specification of Error Upon Which the Appellant, Capitol Chevrolet Company Intends to Rely.

I.

The decision and judgment are contrary to the law and the evidence. The evidence is insufficient to prove negligence or liability on the part of Capitol Chevrolet Company:

(a) There being no contractual relationship between plaintiff and appellant, the only basis for liability must be negligence and there was no proof of such negligence.

(b) There is no substantial evidence to support the finding by the trial court of negligence on the part of the Capitol Chevrolet Company. The finding is contrary to the evidence.

(c) If negligence is assumed, plaintiff is guilty of contributory negligence.

II.

The Court erred in the admission and exclusion of evidence.

(a) Proof of the price paid for tires and tubes by the Government was inadmissible as evidence of the value of such articles.

III.

The Court erred in its determination of damages in respect to the number and value of the articles involved. Finding II of the Finding of Fact has no support in the evidence and is contrary to the evidence.

IV.

The lack of proof regarding the value and the uncertainty render the judgment void.

Statutes Involved.

Warehouseman's Act, Civil Code of California, Section 1858e. Liability for Loss by Fire.

"No warehouseman or other person doing a general storage business is responsible for any loss or damage to property by fire while in his custody, if he exercises reasonable care and diligence for its protection and preservation."

I (a).

There Being No Contractual Relationship Between Plaintiff and Appellant the Only Basis for Liability Must Be Negligence.

Respondent had no contract with appellant.

Whatever the obligation of appellant might have been to the Lawrence Warehouse Company, it owed none to respondent as far as contractual liability is concerned.

Even if it be assumed that appellant was an agent of the Lawrence Warehouse Company, an agent is not liable to a third person for injury resulting from omission of the agent to perform a duty owed to his principal by reason of the agency. (3 C. J. S. 134; Mechem on Agency, Secs. 569, 572, 573.)

Mauer v. Egan, 182 N. Y. Supp. 180; *Knight v. Atlantic Coast L. R. Co.*, 73 F. (2d) 76; *Kelly v. Robinson et al.*, 262 Fed. 695; *Macutis v. Cudahy Packing Co. et al.*, 203 Fed. 291; *Clark v. Chicago R. I. & P. Ry. Co.*, 186 Fed. 539; *Floyd v. Shenango Furnace Co. et al.*, 186 Fed. 505, 514; *Kelly v. Chicago, etc. Ry. Co.*, 122 Fed. 286, 289; *Steinhauser v. Spraul*, 127 Mo. 541, 27 L. R. A. 441.

As said in *Macutis v. Cudahy Co.*, *supra*, "The consensus of judicial opinion is such that this cannot be a fairly debatable question."

See also 20 A. L. R. 97; 49 *ibid.* 521 and 99 *ibid.* 408.

I (b).

There Is No Proof of Negligence on the Part of Capitol Chevrolet Company; Finding V Has no Substantial Evidentiary Support and Is Contrary to the Evidence.

The trial court did not base its finding on any act of the defendant, Capitol Chevrolet Company, but only from an omission. The trial court based its finding upon the answer to the following query:

“Does it appear, from a preponderance of the evidence, that defendant warehouseman failed to take reasonable precautions for the prevention of fire and for its extinguishment after it occurred, thereby causing or contributing to the plaintiff’s loss?” [R. p. 70.]

The court stated:

“In my opinion, the evidence fully justifies the inference that Capitol Chevrolet Company failed to take reasonable precautions which proximately contributed to the fire loss. Upon the defendant warehousemen rested the duty of anticipating fire hazards and maintaining proper and preventive lookouts. This is patently obvious when, as here, they stored valuable inflammable material in a wooden structure in a semi-rural area, outside the city limits and too far beyond speedy access of fire fighting equipment.” [R. pp. 70-71.]

This statement ignores the legal duty of appellant and the evidence and the factual circumstances of this case. In *Wilson v. Southern Pacific R. R. Co.*, 62 Cal. 164 at 172, the court said:

“The negligence of the appellant, as the proximate cause of the loss of property by fire, thus became the essential fact to recovery; and the burden of proof

was upon the plaintiff in the action. It is incumbent on him to prove that the defendant had, by some act of omission, violated some duty by reason of which the fire originated; or that some negligence or want of care, such as a prudent man would take under similar circumstances of his own property, caused or permitted, or contributed to cause or permit, the fire by which the property was destroyed.”

The evidence is undisputed that the tires were stored as the Government wanted them stored, and that under the ordinary circumstances as viewed by reasonable and prudent persons they were in a reasonably safe place, and that there was no risk of fire. The character of the place thus selected by the Government itself and provided by the appellant for the storage of the property; the character of the storage which the Government sought in this matter and the precaution taken by way of having a watchman present twenty-four hours a day; the presence of fire hydrants, and all of the circumstances show that the appellant exercised the ordinary care required of him under all of the circumstances of this case. The court could only reach Finding V which follows this opinion by ignoring the clear evidence in this case which is as follows:

1. It was the Government that was looking for a place to store the tires and it had difficulty finding one.
2. The place selected was the Government's selection not the defendants.
3. The defendants only picked the place because the Government had selected it as the site and because it had Government approval with full knowledge of all the surrounding conditions.

4. As a matter of fact, the location was away from other hazardous buildings and places which ordinarily might be set afire and away from places where the damage might be anticipated.

5. The place was equipped with water fixtures.

6. The firm of watchmen selected and approved by the Government was constantly watching the place.

7. The Exhibits on page 337 shows fire hydrants at four corners of the building.

8. Appellant Capitol Chevrolet Company did all that was required of it to store and safeguard the tires. It acted as a reasonably prudent person or corporation would do under the same or similar circumstances.

9. It could not be reasonably anticipated that fire would occur.

We will detail each of these and other matters further hereinafter.

The responsibility of appellant under this contract was governed by the standards governing warehouses in California [R. 314]. Appellant was not an insurer of the goods. Paragraph 11 [R. 313] relieves either principal.

Under the standard set out in all of the California cases the burden of showing negligence and that such negligence was the cause of the fire rested upon the plaintiff. This burden was not met.

Negligence is the failure to do what a reasonably prudent person would do under all of the same or similar circumstances. Certainly Capitol Chevrolet Company comported with this standard.

Finding V reads as follows:

“On April 9, 1943, defendants Lawrence Warehouse Company and Capitol Chevrolet Company failed and omitted to exercise reasonable care and diligence for the protection for the protection and preservation of said goods so deposited and stored by plaintiff in this, that said defendants negligently permitted the use of said torch on said premises and negligently failed and omitted to see that it was used in a careful manner, and to provide adequate protection for said premises and said goods against the use of said torch, and maintained said premises and said goods in a negligent and careless manner so as to permit them to become ignited and destroyed by fire. By reason of such negligence and carelessness said premises and plaintiff's said goods were consumed and totally destroyed by fire.” [R. pp. 80-81.]

Only by disregarding undisputed competent testimony of witnesses, the legal effect of contractual documents, and the applicable law is it possible to sustain the above finding as it pertains to this appellant.

In reference to the Capitol Chevrolet Company, the opinion reads:

“Furthermore the evidence discloses that Capitol Chevrolet Company failed to have anyone at the warehouse premises to keep a lookout for possible fires or fire hazards and do whatever was reasonably required to guard against such occurrences. No inquiry was made, when McGrew was permitted to enter the premises, as to his intentions and mode of procedure. Nor did Capitol Chevrolet Company ascertain, after McGrew's entrance, what he was actually doing, although at the time of the fire, he had already been using the torch the day previous and

during the morning of the day of the fire. This, despite the fact that his torch and welding equipment were in plain sight outside the engine room. Also, it appears that there was no fire fighting equipment available at the premises with which a fire, such as the one McGrew started, could have been combatted.” [R. pp. 70-71.]

The opinion in addition to the matters above quoted reads:

“There remains to be determined whether there is direct liability of Capitol Chevrolet Company to plaintiff. It cannot be disputed that Capitol Chevrolet Company accepted the tires for storage. Thereby it became a bailee for hire for the benefit of plaintiff. And there then rested upon it the legal duty toward the plaintiff to use due care for the preservation of plaintiff’s property.” [R. p. 72-73.]

and

“Capitol Chevrolet Company is not excused because its principal is liable, for it is its statutory and common law duty as well as its contract obligation which subjects it to liability.” (Citing cases.) [R. p. 73.]

But none of these authorities hold that a person in the position of appellant is either negligent or liable under any circumstances even remotely like the case at bar.

In charging appellant with negligence in having “stored valuable inflammable material in a wooden structure in a semi-rural area, outside the city limits and too far beyond speedy access of fire fighting equipment”, the court assumes conditions contrary to the evidence and to admissions of plaintiff’s counsel made during the trial.

The language of the opinion entirely ignores exceptional features of the instant storage arrangement which when understood and considered render the above statement a factual and legal absurdity.

No one who is unacquainted with the evidence in this case, and who reads the court's last quoted statement would dream it possible that the Defense Supplies Corporation had selected the Ice Palace as a desirable storage warehouse before the Chevrolet Company sought to lease it, and that prior to the leasing said corporation "authorized appellant" to enter into a lease and use these premises for storage purposes", and for "storing these tires".

However, plaintiff's counsel, Mr. Miller so stated and said, "we are not going to contend or attempt to show that did not take place." [R. pp. 9, 111.]

Yet the court strongly implies that appellant, having a wooden warehouse in an outlying area, took it upon itself to receive in the ordinary course of its business "valuable inflammable material" from a depositor who relied entirely upon appellant's judgment as to the safety of the place, and in this manner delivered said material for storage. According to Mr. Miller's frank statements to the court, and approval of statements by counsel for the Lawrence Warehouse Company, plaintiffs employed an agent whose business it was to locate suitable storage places, and, among others he picked out the Ice Palace.

Prior to that plaintiff had made arrangements with the Lawrence Company through a "kind of Master Contract" to enter into agreements of the type shown herein in Exhibit 1, it being understood that it would, under agreements approved by plaintiff entered into agency agree-

ments in the form of its agreement with appellant, being Exhibit 11. [R. p. 341.]

Mr. Henry described the building as follows:

“The main building consisted of a frame building approximately 200 feet wide and 400 feet long, and at the end of the building there was a refrigeration room where the motors and the refrigerators were operated, and that building was approximately 25 to 30 feet wide—about 25 feet wide and about 40 feet long, approximately, and it was separated from the main building by a concrete wall, and had a fire-proofed roof on it, and it had steel girders, and a concrete floor; and between this refrigeration room and the main building there was a fire door. That is about the characteristics of the building.” [R. pp. 160, 161.]

The map [R. p. 337] shows a fire hydrant at each corner of the building. No one testified that these hydrants were not available or properly equipped.

The District Judge erred in concluding, as a matter of law, that it could reasonably be anticipated that the location and the building was such that it required other protection than a twenty-four hour lookout and guard by the Burns Agency men, together with the exclusion of everyone from entrance thereto except those on its list, and plus the four fire hydrants.

It has been pointed out that the opinion relies upon certain, cited authorities, as well as California Civil Code Section 1814 in holding that since appellant was a bailee “it owed the legal duty toward plaintiff to use due care for the preservation of plaintiff’s property” and “is not excused because its principal is liable, for the statutory and

common law duty as well as its contract obligation subjects it to liability.”

Let us pass to the next alleged negligent omission of duty.

The opinion declares that appellant “failed to have anyone at the warehouse premises to keep a lookout for possible fires or fire hazards” to do “whatever was reasonably required to guard against such occurrences.”

From this assertion, surely no one would suspect that the plaintiff itself had undertaken by a kind of joint custodianship with its agent the Lawrence Warehouse Company to provide its own guards and lookouts, and that in this way it maintained a twenty-four hour continuous safeguard of its valuable property in the wooden warehouse of its own selection. But this is the situation which the record shows, and thus the opinion and the evidence are as far apart as two disassociated and conflicting concepts can be.

W. R. Kissell testified that he was employed by the Burns Detective Agency as a watchman at the Ice Palace. That he received his instructions from Mr. Burns or Mr. Harris of that agency. [R. p. 279.]

Counsel for plaintiff stipulated:

“That the guards were employees of the Burns Detective Agency; that arrangements were made with the Burns Detective Agency by the Lawrence Warehouse Company at the request of the Defense Supplies Corporation; that the Burns Detective Agency was paid by Lawrence Warehouse Company, and that Defense Supplies Corporation reimbursed the Lawrence Warehouse Company for the cost of the guard service.”

He also said: "We will stipulate the RFC approved the Burns Detective Agency as an agency." [R. p. 285.]

Mr. Kissell also testified that he was in no way employed by the Capitol Chevrolet Company, and that "they had no authority 'over him' whatsoever." [R. p. 286.]

He said that Mr. Harris furnished him with a list of the persons who were eligible to go into the building. [R. p. 288.]

The witness said that there were two other watchmen, and he was the one on duty at the time of the fire. He worked from eight o'clock a.m. until four p. m. [R. p. 294.]

The stipulation of plaintiff's counsel, alone, warranted the statement which has been made concerning the arrangements between plaintiff and the Lawrence Warehouse Company, and it proves that, as far as guarding the warehouse was concerned, plaintiff, alone, or plaintiff and the Lawrence Warehouse Company were the actual custodians of the tires and tubes.

The District Judge's opinion assumed otherwise.

By this procedure, many difficult questions were bypassed, such as the much briefed burden of proof issue, as well as scrutiny of the unusual divided custodianship and other qualifications of the warehousemen's responsibilities as fixed by said code provision.

However, *the custodianship was divided*. In a note to the opinion, it is said that "the evidence indicates that the armed guard service was a purely additional and independent protective activity to prevent pilferage of the tires." There is not even a shred of evidence in the record

to show that the guards were placed at the warehouse for the limited purpose of preventing pilferage, or that it was an "additional and independent activity" on the part of the Defense Supplies Corporation.

The plain and only import of Mr. Miller's stipulation is that appellee herein saw fit to choose and designate who the Lawrence Company should employ to guard the valuable property entrusted to it, and considered the matter of such importance that it agreed to reimburse the Lawrence Warehouse Company for the superior policing services of the Burns Agency.

Surely, Mr. Kissell would not be expected, in the performance of his duties, to stand idly by while subversive-minded persons sabotaged the entire Ice Palace by blowing it up with dynamite from the outside or by starting a huge conflagration against its wooden sides. Of course, the Burns' men were regular watchmen who maintained a twenty-four hour guard, which is about as complete as the laws of man and nature permit. It is a matter of common knowledge that this is an outstanding detective agency.

It follows that all of the alleged negligent omissions of duty assigned by the District Judge against appellant were actually attributable to appellee or appellee's own watchmen. It was they who failed to discover until the second day of its use the presence of the torch and welding equipment; it was Mr. Kissell who after observing these dangerous instruments in action, merely walked away and permitted their use to continue. [R. 296.] It was Kissell to whom was addressed and presented the note which asked that McGrew be permitted to enter the premises. [R. 339, 280.]

Every omission of performance of a duty enumerated in the opinion as against appellant is comprehended in those which have been exploded and left harmless, namely the several failures, to-wit, to have anyone at the warehouse to keep a lookout, failure to refuse admission to McGrew and his torch and failure to discover it, and the original failure to store the article in a safe storehouse, in a proper location.

Within the last named negligent omission should be included the fire fighting equipment available at the premises, which the court said “appears” not to have been present.

This negligence, if it be such, is clearly attributable to plaintiff and its officers, who found and selected the Ice Palace and brought about the leasing thereof by the Chevrolet Company. They, of course, observed that the Ice Palace was “wooden” and that it was in a “semi-rural area” and “outside the city limits and too far beyond speedy access of fire fighting equipment.”

Also, the appellee’s immediate agent, must have noted that “there was no fire fighting equipment available at the premises.”

In spite of these conditions, Appellee encouraged and approved the leasing of the Ice Palace, and who can say and how can a court take judicial knowledge that appellee and its agent did not wisely exercise their judgment and discretion.

The location of the Ice Palace had obvious advantages. It was well isolated from other buildings or inflammable matter, which are commonly known to constitute the greatest of hazards.

Mr. Kissell testified that "The space from the highway" on which the warehouse faced was "a clear, open space" in all directions, "to the north"; "to the west and south"; and "to the south there is a large field there." [R. p. 299.]

This is a concrete example of how great an error in law may result from error arising from failure to observe the undisputed facts. As has been shown, the conceded and stipulated facts show that the Ice Palace Warehouse was conducted under the divided control of appellant, the Lawrence Warehouse Company and appellee, and that with respect to safe-guarding the stored articles, appellee retained the principal, if not the exclusive control.

Attention is now directed to the decisions cited in said opinion as above mentioned. From *Franklin v. May Department Store*, 25 Fed. Supp. 735, the only Federal case in the list, we shall quote at some length. The Department Store, and its manager, Saifer, were sued for injuries to the plaintiff's wife, the complaint charging nine omissions to perform duties alleged to be owing to their customers. The opinion states:

"The motion to remand is based upon the assumption that the petition states a cause of action against the resident defendant Saifer. If the above quoted language fairly implies that Saifer had complete and exclusive authority over the management (*Orcutt v. Century Bldg. Co., et al.*, 201 Mo. 424, 99 S. W. 1062, 8 L. R. A. N. S., 929) or control (*Lambert v. Jones*, 339 Mo. 677, 98 S. W. (2d) 752) of the building plaintiff's position is well taken. It will be noted that the language used does not allege complete and exclusive management or control in Saifer but to the contrary states that the corporate defendant is operating the building. True, it is alleged that the

Corporation is operating the building through its agents and representatives, but such an allegation implies control by the Corporation of the "agents and representatives" rather than that exclusive control was vested in one particular agent. Fairly interpreted the meaning of the petition is in substance that the corporate defendant was managing and controlling the operation and maintenance of the building and door in question and that the defendant Saifer was its employee "in charge of the use, operation and maintenance" of the door under the managing direction of the corporate defendant. Under these circumstances the petition charges only non-feasance on the part of Saifer. Nowhere is it alleged that Saifer was guilty of active negligence as distinguished from non-feasance. See *State ex rel. Hancock v. Falkenhainer*, 316 Ni, 65km 28k S. W. 466. There can be no recovery from an agent or servant for non-feasance alone unless the agent has assumed and actually commenced such a complete and exclusive control of management or operation as to warrant saying that he failed in discharging or completing a duty theretofore assumed and commenced."

In the instant case the Chevrolet Company was not even an agent of the plaintiff, but this lack of relationship presents an additional but kindred ground for the invalidity of the judgment which has been argued in this brief.

It is certain that under the doctrine of the *May Department Store* case appellant has no liability, for, as has been shown, because the selection of the Ice Palace as a suitable warehouse and safeguarding of appellees tires and tubes were functions which were undertaken by it.

Appellee called its watchman, Kissell, as a witness. By his undisputed testimony it proved that through the Burns

Detective Agency, the appellee exercised full control of the warehouse in all matters pertaining to safeguarding its goods.

It has been shown that appellee provided its own watchman and thereby maintained a twenty-four hour a day outlook.

Mr. Kissell further testified that the Burns Agency issued the watchmen instructions and that it was their order, "not to let anything be moved from the premises unless there was an order from the Capitol Chevrolet Company." [R. p. 279.]

This can mean only one thing as to where rested the general authority as to the removal of articles from the warehouse. Does one who lodges goods in a warehouse have authority under an ordinary deposit agreement or the applicable law to restrict the removal of any goods except his own therefrom? Of course, the answer is negative.

Hence, the assumption of that right, itself, proves, at least *prima facie*, that appellee had and exercised a power, beyond an additional to safeguarding the premises.

Mr. Kissell's testimony has been quoted by which he swore that the Capitol Chevrolet Company "had no authority . . . whatsoever," over him. [R. p. 286.]

Also, Kissell testified that he had "a list of persons who were eligible to go into the building", which list was given to him by Mr. Harris. [R. p. 288.]

The opinion of the District Court declares that the responsibility of appellant is that provided in Section 1814 of the Civil Code of California: Nowhere in that code is it provided that a warehouseman may not decide who shall

be eligible to and who shall not be eligible to enter his warehouse and who may or may not remove goods therefrom.

These are functions which inhere in Warehouse Management. In this case the depositor had charge of and regulated these matters, and by its orders excluded all persons from the entire warehouse except those placed on an excepted list, and directed its agents to let no one enter except those on such list, or to permit no one to remove goods from the "premises" except on an order of an agency named by it.

The fact that appellee authorized appellant to give such an order no more tends to show that appellant had exclusive control of the warehouse than would a similar authorization of the Federal Reserve Bank or to John Doe. In either case, the power to issue such an authorization necessarily implies an existing total control of the premises by the party who issues it.

Therefore, such power of control belonged to appellee. We proceed now to examine the record for evidence concerning whose negligence, if negligence there was, caused the destruction of appellee's property. On that occasion Mr. Kissell was the watchman on duty and under the orders above mentioned. Mr. Kissell said, "There was an order from the Capitol Chevrolet Company permitting Mr. Henry to remove this stuff from the engine room". [R. p. 280.] He said this was "a card", and that it said "there would be men there in order to take that steel out of the engine room. That was all there was to it." He said the card was burned in the fire. [R. p. 287.]

Gordon Kenyon, an officer of the Chevrolet Company gave testimony, not inconsistent with that of the watchman, clarifying the matter of the card.

The witness testified that Mr. McGrew asked him to o. k. permission to enter the Ice Palace; that he thought "the card was from Clyde Henry—it was signed by Mr. Henry; that the card showed the man's name was Mr. Sanchez" who presented it to Kenyon, and he "did not know otherwise."

The witness said that either by telephone or in writing he instructed the guard at the Ice Palace to permit Mr. Sanchez to go into the premises and remove equipment. [R. p. 186.]

Kenyon then identified a card as the one which was presented to him. It was marked Plaintiff's Exhibit No. 8 in evidence. [R. p. 187.] This exhibit reads:

"Home Office and Plant
921 Del Paso Blvd.
Sacramento, California
Tel: 9-3045

U. S. MACHINERY COMPANY
1568 RUSS BUILDING
San Francisco, California

CLYDE W. HENRY

Tel: DOuglas 7327
Sacramento, Calif.

To Watchman at Ice Palace:

Please allow bearer, Mr. Tony Sanchez, to enter with his two men to remove pipe & equipment.

(s) CLYDE HENRY.

[Endorsed]: Filed Feb. 13, 1945." [R. p. 339.]

Mr. Kenyon said the list of persons who were authorized to go upon the premises is shown on Plaintiff's Exhibit 10, which was also placed in evidence after being produced by appellant's counsel and identified as having been received by Kenyon. [R. p. 199.] It reads:

“MEN ELIGIBLE TO ENTER D S C WAREHOUSE

Jas. A. Kenyon, Pes.

H. C. Gerhart, Warehouseman

A. Koletyke, Chief Tire Appraiser

Mr. Turner, Realtor

Mr. Henry, Part Owner

Mr. Petrillo, Part Owner

G. A. Kenyon, Supervisor

Tire Pilers & Stackers

George Forshay

Louis Hill

Dale Borden

Edward Schubert

G. E. Allison

Dale Wilson

Melvin Parr

George Shaw

Don Cole

[Endorsed]: Filed U. S. D. C. Feb. 13, 1945

[Endorsed]: Filed U. S. D. C. Sept. 4, 1946.”

[R. pp. 340-341.]

The witness, also, said he received a letter which is “Plaintiff’s Exhibit 9”. It reads:

“Dear Mr. Kenyon:

You are requested not to permit anyone to enter the warehouse premises where tires are stored for account of this corporation for any reason whatsoever, other than authorized appraisers or properly identified employees of this corporation.

In the near future, however, you may be called upon by a representative of the Rubber Manufacturers Association of America, Inc., which organization is to handle the distribution of the tires acquired by us, and upon proper identification from such representative entrance to the warehouse and examination of any tires may be permitted. Your strict observance of the above will be appreciated.

Very truly yours,

F. J. TITGEN, Agent.” [R. p. 192.]

In *Brady v. Southern Co.*, 320 U. S. 476, the Supreme Court quoted with approval from *Milwaukee & St. P. R. Co. v. Kellogg*, 94 U. S. 469 at 475, as follows:

“‘But it is generally held, that, in order to warrant a finding that negligence, or an act not amounting to wanton wrong, is the proximate cause of an injury, it must appear that the injury was the natural and probable consequence of the negligence or wrongful act, and that it ought to have been foreseen in the light of the attending circumstances.’ ”

The court then says in the *Brady* case:

“Events too remote to require reasonable prevision need not be anticipated.”

There is absolutely nothing in the evidence in the case at bar to show negligence on the part of the Capitol Chevrolet Co. or an act amounting to wanton wrong which proximately caused the injury nor could appellant by reasonable prevision have foreseen any of the events.

Furthermore, the cause of the fire is not clear. The plaintiff's own witness, by which it is bound, did not establish the cause of the fire but the court assumed that the cause was nevertheless reasonably inferable from his testimony. However, his testimony denied positively that he caused the fire and such an inference is not legally permissible or logical.

I (c).

The Plaintiff Was Guilty of Contributory Negligence.

If the defendants were negligent the plaintiff was necessarily guilty of contributory negligence. It was the plaintiff which picked the location and selected the watchmen.

It is settled law that in warehouse cases as in any others wherein negligence is an issue, proof of contributory negligence is a complete defense. (27 R. C. L. p. 991.)

One precedent has been found which bears a striking resemblance to the instant case.

In *Smith v. Frost*, 51 Ga. 336, Smith had stored cotton in Frost's warehouse. This was during the civil war. The confederate authorities took the warehouse for a hospital and threw the cotton into the street. It was seen there by the defendant and probably by Smith, the opinion states, and it was held that if plaintiff knew or had reason to believe "that it had been so thrown and could have saved" by him "by the exercise of ordinary care" he could not recover.

It has many times been held that inspection by the bailor of a building where storage is without contract, for the express purpose of judging its suitability for storage of his goods relieves the warehouseman of responsibility.

Southerland v. Albany, S. & W. Co., A. A. N. Y. Supp. 835;

Gibson v. Hatchett, 24 Ala. 201;

Brown v. Hitchcock, 128 Vt. 452;

Fay & Bates, 99 Mass. 263.

Where the depositor has full knowledge of the particular conditions before storing goods in a warehouse, if due to such conditions they are damaged, his contributory negligence prevents a recovery.

Allen v. Somers, 73 Conn. 355, 52 L. R. A. 106;

Parker v. Union Ice & S. Co., 59 Kan. 626.

II.

The Court Erred in the Admission and Exclusion of Evidence. Proof of the Price Paid for the Tires and Tubes by the Government Was Inadmissible as Evidence of the Value of Such Articles for Several Reasons.

1. None of the defendants, including appellant in particular, participated even remotely in the purchase transactions.

The witness by whom the plaintiff essayed to prove the cost of the destroyed property testified that he had no personal knowledge of the matters which he related concerning that subject and that his testimony was based solely on his memory of the contents of documents prepared by others, which were not produced in court, but it would have been inconvenient to do so.

Hence, such testimony was double-hearsay. The documents themselves would have been hearsay, and Mr. McClellan's hearsay testimony was based on such unsworn hearsay documents.

2. The sales were made under compulsion and the tire owners were compelled to accept the prices perfunctorily offered them by plaintiff, and purchases so made and prices so fixed, morally, logically and legally are devoid of evidentiary value as proof of the fair market value of the articles involved.

1. The Applicability of the Hearsay Rule Will Now Be Shown.

The courts will not receive the testimony of a witness as to what some other person told him as evidence of the fact asserted. The rule of exclusion is the same whether the evidence offered consists of statements purporting to

be based on the declarant's own knowledge or whether his statements are sworn or unsworn, oral or written.

31 C. J. S. p. 919.

Wigmore says: "The essential requirement of the hearsay rule, as just examined, is that statements offered testimonially must be subjected to the test of cross-examination." The right, as safeguarded by the hearsay rule this learned authority regards as entitled to esteem "next to jury trial, the greatest contribution" to the anglo-American law of evidence.

V. Wigmore on Evidence (3d Ed.) p. 27.

Greenleaf on Evidence, "the old reliable", asserts: "The hearsay rule is constantly expounded as 'the general rule of not receiving evidence unless upon oath and with the opportunity of cross-examination.'" Quoting eminent authorities, Greenleaf shows that the rule is fundamental and not technical and that it precludes hearsay evidence from one not a party to the suit from being related by a witness because the declarant could not be cross-examined.

1 *Greenleaf on Evidence* (16th Ed.) pp. 183-185.

All authorities agreed that hearsay evidence is incompetent and wholly inadmissible unless there is a recognized exception to the rule which covers the case.

"The rule excluding hearsay is a basic rather than a technical rule."

31 C. J. S. p. 924.

The evidence of which complaint is made as violative of the hearsay rule in this case is unquestionably hearsay. Appellant's counsel knows of no exception which covers it

and the record fails to reveal the theory on which such evidence was considered within some exception either by plaintiff or the court, nor does the opinion of the trial judge mention this question.

Mere recital of the evidence in question will suffice to establish its hearsay character, in fact much of it is double-hearsay.

The hearsay rule is so clear and well understood that instances of double-hearsay evidence being received or produced are infrequent.

However, cases involving unsworn hearsay writings, themselves, are not difficult to find.

The following are applicable by analogy:

In *Ogilvie v. Aetna L. Ins. Co.*, 189 Cal. 406, it was held that the written report and findings of the County Autopsy Surgeon to the Coroner was hearsay and incompetent. The action was on a policy insuring against bodily disability by certain means.

In *Pierce v. Patterson*, 50 Cal. App. (2d) 486, a malpractice suit, it was held unnecessary to decide whether County Hospital records of the case were hearsay. The opinion states that they were properly excluded as it was not shown that such records "were required to be kept by law."

In the instant case no attempt was made to show that the unidentified records of the Defense Supplies Corporation, to which Mr. McClellan said he had access, [R. p. 113], were required to be kept by law. Mr. McClellan made a written memorandum from said records on which he relied in testifying. [R. p. 124.]

In *Lusardi v. Prukop*, 116 Cal. App. 506, an action for damages for personal injuries, records of an emergency hospital were held to be hearsay and improperly admitted. No foundation was laid to show that the entries were made in the performance of a duty enjoined by law, and this to bring them within the exception to the hearsay rule provided in Section 1926 of the State Code of Civil Procedure.

It is said: "The hearsay rule is applicable to written instruments as well as to oral statements (10 Cal. Jur. p. 1039). Testimony based upon memoranda made by others when the witness has no knowledge of the facts except from such memoranda is hearsay evidence", citing cases.

Since appellant was not a party to it, the verdict of a Coroner's inquisition was held inadmissible hearsay in *Estate of Dolbeer*, 149 Cal. 573.

To the same effect are *Mar Shee v. Maryland Assurance Co.*, 190 Cal. 1, 3, and *Hollister v. Cordero*, 76 Cal. 649.

In *Holland v. Kelly*, 74 Cal. App. 576, delivery tags purporting to record deliveries of liquor by a liquor dealer were erroneously admitted in evidence. The opinion states that they were made without the knowledge of the plaintiff and were unsworn statements of a person not a witness or subjected to cross-examination, and, therefore, hearsay and incompetent.

In the *Lusardi v. Prukop* case, the court said:

"The proffered evidence was hearsay, concerning which Greenleaf on Evidence, volume 1, section 99, says: 'Hearsay evidence, as thus described, is uniformly held incompetent to establish any specific fact which in its nature is susceptible of being proved by witnesses, who can speak from their own knowledge.' "

In the instant case the facts set forth in plaintiff's records, a memorandum from which was the basis of Mr. McClellan's testimony, were susceptible of being proved by witnesses who could speak from their own knowledge.

Upon the same ground, where the owner did not participate in the assessment, the assessed valuation of property has been almost universally held inadmissible to prove its value for any other than tax purposes in any suit to which the owner is not a party.

- San Jose & A. R. Co. v. Mayne*, 83 Cal. 566;
Bartlesville Interurban Ry. Co. v. Quaid, 151 Pac.
891 (Okla.), L. R. A. 1918A, 653;
Denver R. Co. v. Heckman, 45 Colo. 470;
Oldenberg v. Oregon, Sugar Co., 39 Ore. 564;
Lewis v. Englewood Elev. etc. Co., 223 Ill. 223;
Shea v. Boston etc. R. Co., 217 Mass. 163;
Calahan v. Dunker, 51 Ind. App. 436;
Kelly v. People's Nat. Ins. Co., 262 Ill. 158;
Hanover Water Co. v. Ashland Iron Co., 84 Pa.
279;
Carper v. Risdon, 19 Colo. App. 530 (conversion);
Starrs v. Robinson, 74 Conn. 443;
Anthony v. New York etc. Co., 162 Mass. 60;
American State Bk. v. Butts, 111 Wash. 612;
Putnam v. White, 88 So. 355, (Ala.);
Con. v. Tryon, 31 Pa. S. Ct. 146;
Ridley v. Seaboard etc. R. Co., 124 N. C. 37;
Girard Tr. Co. v. Philadelphia, 248 Pa. 179;
Re Northlake Ave., 96 Wash. 344;
Dudley v. Minn. etc. Co., 77 Ia. 408;
McNulty v. Lawley, 42 Cal. App. 747;
Yolo K. & P. Co. v. Edmonds, 50 Cal. App. 444.

As said in *Scott v. O'Neil*, 23 Ky. L. Rep. 331, 62 S. W. 1042, "The evidence of what the property was valued at in assessment for taxation was wholly irrelevant. It was but hearsay; the opinion of the assessor or of the taxpayer, given out of court and with no opportunity for cross-examination." (See, also, 5 *Nichols Applied Evi.* p. 4579.)

2. The Court Erred in Receiving in Evidence Testimony Based on Documents Purporting to Show Prices Paid by Plaintiff for the Articles Destroyed, Because the Sales Were Coerced and Forced.

The tires and tubes were not sold to plaintiffs in an open market. The prices were not accepted by the sellers voluntarily and in the exercise of free will.

The real purchaser was the United States Government and it had previously excluded all would-be or possible competitors from the market, and had fixed its own price and, by implication of law, had declared to all who owned such articles: You must not keep them whether you can use them or not and unless you sell them to me at the prices I offer, you cannot sell them at all.

The plaintiff's witnesses fully recognized this situation; it is a matter of common knowledge and of law.

The laws which accomplished this taking of property, probable without due process, were warranted by the necessities of the war and the Government's war powers. However, this was true, not because the United States even under such powers could indiscriminately take people's property arbitrarily or capriciously, but for the sole reason that rubber was direly needed in the war struggle.

A different situation exists when, the needed rubber having been burned, the Government, in an ordinary civil suit to recoup its loss, asks a court for judgment for the value of the rubber.

Now no impelling necessity gives the United States or one of its corporate bureaus exemptions, priorities or rights to short-cuts not possessed by any other corporation or other litigant.

Appellant insists that without the invention of some judicial theory unknown and foreign to established principles and rules of evidence, by reason of legal and factual conditions created by the Government, it is probably precluded from any, except a nominal judgment in cases of the nature of this, and it certainly is so precluded by the record in the instant case.

The court erred in receiving evidence testimony based on documents purporting to show prices paid by plaintiff for the articles destroyed, because the sales were coerced and forced. The price paid does not tend to establish market value and plaintiff's evidence shows that the sales herein involved were not according to market value.

In this case plaintiff's counsel proceeded on the theory that market value could not be proved and, therefore, that any other evidence relevant to the value issue was competent and admissible, and that the evidence showing the cost of personal property to the owner, although not conclusive is relevant, where the property has no market value.

These general rules presuppose that the dealings involved are normal. Market value is the fair price paid in the open market¹ where buyer and seller bargain on equal terms and agreements reached are voluntary.²

Appellant maintains that this fundamental principle likewise conditions the competency of evidence as to cost, which, if received is admitted as secondary evidence of market value. (*John Mouat L. Co. v. Wilmore*, 15 Colo. 136; *Hollinger v. Missouri etc. Ry. Co.*, 94 Kan. 316; *Union Pacific etc. Ry. Co. v. Williams*, 3 Colo. App. 526.)

The evidence of costs was offered in this case upon this theory. Plaintiff's counsel said in that behalf:

"I think in the absence of market value, any evidence of cost or value is material to determine the loss which the plaintiff suffered in the destruction of these tires. In the finding of market value the court may consider all possible elements of value, including the cost to the owner of the property." [R. p. 133.]

¹Market value means the price for which an equivalent could be reasonably and fairly purchased at or near the place where the property should have been delivered or where the transaction occurred. *Bullard v. Stone*, 67 Cal. 477; *Shurtleff v. Marcus Land, etc. Co.*, 59 Cal. App. 520; *People v. Schwartz*, 78 Cal. App. 561; 578; *So. Cal. Edison Co. v. Ind. Acc. Com.*, 96 Cal. App. 337. (Cal. C. C. Sec. 3354.)

²*Muser v. Magonc*, 155 U. S. 240, 39 L. Ed. 135; *State ex rel Highway Com. v. Stoddard Gin Co.*, 62 S. W. (2d) 940 (Mo. App.); *Olson v. U. S.*, 292 U. S. 246, 78 L. Ed. 1236; *Appeal by Borough of Melbourne*, 329 Pa. 321, 198 Atl. 49; *Ins. Co. of N. America v. McGraw*, 255 Ky. 839, 75 S. W. (2d) 518; *River Park Dist. v. Brand*, 327 Ill. 294; 158 N. E. 690; *Packing Co. v. Sunland Sales, etc. Assn.*, 100 Cal. App. 126, 132 (26 Words & Phrases, pp. 565-575.)

However, scores of decisions quoted in Words and Phrases under the caption "Market Value Price at Free Sales" and other captions, *supra*, repeat, as a part of the definition of the term "market value" in substance, that it is "not what the property would bring under a forced sale" but what "a willing owner" who "is not compelled to sell" would take and "one who wants to purchase under ordinary circumstances" would be willing to pay.

It is implicit in all of these decisions that, as expressly stated in *Wall v. United Gas etc. Co.*, 178, La. 908, 152 So. 561, market value is not a price arbitrarily fixed by one party but is the actual price at which a given commodity is currently sold "in the usual and ordinary course of trade and competition between sellers and buyers equally free to bargain," etc.

It is safe to say that no reputable authority can be produced which maintains that value (whether established by evidence of "market value", or, in lieu thereof, by proof of cost, sales of similar articles or other means), can be proved by evidence based upon coerced sales or other transactions.

In the instant case the plaintiff's own witness established the fact that the tires and tubes herein involved were purchased from owners who sold under compulsion and at prices arbitrarily fixed by the real purchaser, the United States Government.

Plaintiffs Uncertainty as to Following Its Own Program Adds to the Conjectural Character of Its Proof.

It was shown that the price list which McClellan produced as the list given the appraisers, and which he claimed followed OPA ceiling prices [R. pp. 133-135] differed from the OPA ceiling price.

Appellant's counsel introduced in evidence "Defendant's Exhibit 13" which purports to be the OPA Price Regulation showing ceiling prices for tires. [R. p. 301.]

This regulation as compared with the list of prices set forth in Plaintiff's Exhibit 4, being a schedule of prices to be paid for used tires differs in that Plaintiff's Exhibit 4, Grade 4, prices the tires at \$2.75 each, whereas the OPA Regulation price for the same tires was \$1.50 each. [R. pp. 303, 304.]

Defendant's Exhibit B shows the dates of issuance of OPA price lists as December 30, 1941, March 7, 1942 and January 31, 1942.

The purchases of tires by plaintiff were said by its counsel to have been made on October 15, 1942 [R. p. 306]. Hence, the OPA schedule dated March 7, 1942, applied to plaintiff's purchases, and the price above stated of \$1.50 per tire was the OPA ceiling price.

Conflict Between Buying and Selling Prices.

Another factor, and one which not only adds another contingency to the possible dependability of Mr. McClellan's testimony as to prices actually paid for tires, but renders his averages uncertain and conjectural, was developed in cross-examination.

It must be remembered that in plaintiff's attempt to prove damages the theory followed, as announced by Mr. Miller early in the trial, was, that being unable to prove market value, the prices paid for articles destroyed, arrived at by averaging the prices paid for such articles in the entire area, would be produced and relied upon as establishing "what they were actually worth, because they did have a value." [R. p. 118.]

If Damages Are Possible at All They Could Only Be Nominal Damages Under the Evidence.

Mr. McClellan said The Idle Tires Program started, officially, on October 15, 1942. [R. p. 141.]

Plaintiff witness McClellan testified on direct examination that the purpose of The Idle Tires Program was to obtain control of all waste rubber in the United States; that owners of tires could not sell them to other persons; that "they were required to sell them to the Government; that the prices were fixed by the government; that the maximum number they could retain was five." [R. pp. 127, 128.]

On cross-examination by Mr. Wallace for the Lawrence Warehouse Company, Mr. McClellan testified that the appraisals of the tires was done by "appraisers appointed by us," and with this matter the warehouse company had nothing to do [Rep. Tr. p. 147]; and the witness said that these appraisers "appraised and graded these tires." [R. p. 151, lines 9-11.]

By the foregoing testimony, the plaintiff proved:

1. That at the time when plaintiff purchased the tires and tubes destroyed by the fire, alleged to have been the

result of defendants' negligence, by reason of the O.P.A. Regulations these articles had no market value.

2. That owners of tires could not sell such articles except to the United States Government.

3. That such owners were not free to bargain and had no power to fix the price and could not participate in that matter.

4. That such owners were compelled to sell all tires owned by them in excess of five for one automobile.

5. That the prices for which owners must sell were arrived at by following O.P.A. ceiling prices, established according to grade, and by the plaintiff's appraisers, who graded the tires.

6. That, as far as any owner having any voice in selling his tires or in arriving at the price to be paid, and the decision to sell, he was a mere interested bystander for these matters were all arbitrarily determined by others, namely the Office of Price Administration and the appraisers of the plaintiff, acting as agents of the Federal Government.

In other words, the owners' property was taken without a hearing, without opportunity to cross-examine any witness or refute any evidence, oral or written, upon which the price-fixers may have relied, and he was compelled to sell.

The procedure is unique but most resembles condemnation of property minus the hearing and with the unbridled power of the Government to fix the prices superimposed.

The compensatory judgment in this case is founded upon cost prices so established.

Appellant insists that the concept that a judgment so sustained is lawful is preposterous and cannot be legally justified for the following reasons:

1. It is the universally recognized rule that prices paid for property of any kind at forced sale is incompetent and inadmissible as evidence of market value or of actual value.

In addition to the fact that the definition of the term "market value" as announced in substantially all of the applicable decisions, expressly excludes prices at forced sale, we find many cases directly holding as above stated, among which are the following:

Willamet Falls C. & L. Co. v. Kelly, 3 Ore. 99;

Madisonville, etc. R. Co. v. Ross, 126 Ky. 138,
13 L. R. A., N. S. 420;

Chase v. City of Portland, 86 Me. 367;

St. Louis K & A Ry Co. v. Chapman, 38 Kan. 307;

Pittsburgh V. & C. Ry. Co. v. Vance, 115 Pa. 325;

Wagner & C. v. Dunham, 246 S. W. 1004 (Tex.);

Clark v. Logan Mut. L & B Co., 58 Ill. App. 131;

Wall v. United Gas Publ. Ser. Co., 178 La. 908;

San Diego Land & Town Co. v. Neale, 78 Cal. 63,
3 L. R. A. 83;

Little Rock Junction Ry. v. Woodruff, 49 Ark. 381,
4 Am. St. Rep. 51;

Helvering v. New President Corp., 122 F. (2d) 92,
97;

Metropolitan Water Dist. v. Adams, 99 P. (2d)
659;

Appeal of Pitney, 20 N. J. Misc. 448, 28 A. (2d)
660, 666.

In the *Little Rock v. Woodruff* case, *supra*, it is said:

“And when we say that the owner is entitled to receive the price for which he could sell the property, we do not mean the price he would realize at a forced sale on short notice, but the price that he could obtain after reasonable and ample time such as would ordinarily be taken by an owner to make sale of like property.”

In *Helvering v. New President Corp.*, *supra*, the court held inadmissible evidence of the price paid at a foreclosure sale, saying that such a sale “is no criterion of ‘market value.’”

In *Appeal of Pitney*, *supra*, it was held that market value is not “what the property would bring at auction under the hammer” nor “a value obtained from the necessities of another.”

2. A second reason supports the one above elucidated as persuasive that the evidence of cost to the plaintiff was incompetent.

The *sales* and *purchases* of these tires and tubes must be classed as contract transactions. Yet owners were compelled to give up their property and accept prices, not offered, but dictated to them.

It must be remembered that we do not question the legality of such procedure “*in aid of the war.*”

We do challenge the use of prices so established as evidence of the fair market value of the property thus seized, bearing in mind that for evasion, secreting or refusal to give up the tires herein involved, every owner would have been punishable by fine or imprisonment or both. Even a threat of a well founded prosecution against

a criminal to compel him to carry out an agreement or to make a conveyance is duress, and a contract made as the result of such threat, is void.

(See V. Williston and Thompson on Contracts, p. 4512 and columns of cases there cited.)

In *Meyer v. Guardian Trust Co.*, 296 Fed. 789, it is said:

“Unlawful duress is a good defense to a contract, if it includes such degree of constraint or danger, either actually inflicted or threatened and impending, as is sufficient in severity or apprehension to overcome the mind and will of a person of ordinary firmness.”

(See also *Barnett Oil & Gas Co., v. New Martinsville Oil Co.*, (D. C.) 254 Fed. 481; *Galusha v. Sherman*, 105 Wis. 263, 47 L. R. A. 417, 81 N. W. 495; *Schultz v. Catlin*, 78 Wis. 611, 47 N. W. 946; *Hullhorst v. Sharner*, 15 Neb. 57, 17 N. W. 259; *Morrill v. Nightingale*, 93 Cal. 452, 27 Am. St. Rep. 207, 28 Pac. 1068; *Morrison v. Faulkener*, 84 Tex. 128, 15 S. W. 797; *Thompson v. Nigley*, 53 Kan. 664, 26 L. R. A. 803, 35 Pac. 290; also 2 Greenl. Ev., 14th ed. note to sec. 301; Joyce, Defense to Commercial Paper, sec. 105.)

To the same effect, reviewing many decisions, is *Colby v. Title Ins. & Trust Co.*, 160 Cal. 632.

In each of these cases documents were held void which had been executed under threats of prosecution of the maker's relative for a crime of which he was guilty, because as said in the *Colby* case,^a under such circumstances “the obligor is not a free agent” and “is not equal to the task of protecting himself.”

The bearing of the foregoing authorities concerning the effect of duress or coercion on the validity of contracts upon the issue now being presented is the obvious incongruity of holding, as the trial court has herein, that prices paid to sellers who were compelled by law to sell to the purchaser and to accept the prices fixed by it are evidence that such prices are *fair* and show the value which a seller *who wants to sell but is not compelled to do so, and is free to bargain*, would accept, and which a buyer who desires to purchase but holds no bludgeon with which to coerce acceptance of his terms, would offer, namely market value, although in this case the owners of the articles had no choice and no volition—not even as much as the victims of duress in the Colby and Myers appeals and many cases cited in the opinions therein.

Also, this line of authority concurs in principle with, and emphasizes the applicability to the instant case of others previously mentioned herein which hold directly that the price for which property sold at forced sale is inadmissible as proof of its market value or actual value.

The circumstances of the sales through which plaintiff acquired the tires and tubes involved in this case are the very antitheses of those required for the ascertainment of their values.

To be competent evidence of such values it is fundamental that the sale be voluntary; there must be no force or coercion; it must be an open market sale where competition is possible; opportunity must exist for bargaining whereby the seller may exhibit all of the advantages possessed by his property and the purchaser may advance reasons in justification of his offer; no extraordinary conditions may have induced such a sale. It must be in the “ordinary”

course of trading; speculative considerations may not be regarded to unduly enhance the price nor may the necessities of the seller avail to depreciate it.

The instant sales were not voluntary; the force and coercion of the law and the power of the O.P.A. and the plaintiff's appraisers compelled them; no open market existed. Such markets were outlawed by law; bargaining, also, was rendered impossible by law; these conditions were extraordinary and unparalleled.

From the foregoing comparison it is apparent that the vice of the use in the instant case of evidence of cost to the plaintiff as proof of market value, and thus as the measure of damages, is not that the defendants were necessarily damaged, but that such evidence is wholly incompetent, because it is an illegal and improper basis for the judgment. The evidence should have been stricken on defendants motion, as was held concerning similar incompetent and illegal evidence in *Spring Valley Water Works v. Drinkhouse*, 92 Cal. 528, 533.

Had the motions been granted, only nominal damages could have been awarded, for without the "cost" evidence plaintiff produced no proof of substantial damage.

3. When Damages May Be Proved With Approximate Accuracy They Must Be So Proved.

There is a well recognized qualification to the rule which appellee relied upon to establish damages by any "evidence of value which would tend to aid the court in determining what" the tires and tubes "were actually worth." [R. p. 118.]

This well established qualification is based on the reasonable and fair requirement that one who would enlist the

help of equity or equity to extract him from a dilemma, must show that he has exercised diligence and made every reasonable effort to help himself. This principle, as applied to actions for damages, whether for breach of contract or torts, is expressed in the rule which requires that

“When compensatory damages are susceptible of proof with approximate accuracy and may be measured with some degree of certainty, they must be so proved.” (25 C. J. S. p. 496.)

In the instant case, it is apparent that the plaintiff chose to adopt a lazy man’s way of attempting to establish injury and damages. Not having any records, so Mr. Miller claimed, of the tires and tubes actually stored in the Ice Palace Warehouse, at the beginning of the trial, and after Mr. Getz had expressed the view that “the question of damages may be a difficult one”, Mr. Miller addressed the court as follows:

“Mr. Miller: I think that perhaps Mr. Getz is more fearful than I am as to the matter of values; we feel that we can present in rather short testimony evidence that will show the value of the tires that were destroyed. We recognize that there may be a dispute as to the value, but I would like, if you might, to proceed with that testimony.” [R. pp. 102, 103.]

Later, Mr. Miller divulged that this “short testimony evidence” method of proving plaintiff’s case as to the number of tires destroyed and their cost to the plaintiff, was as shown in his statement as to the records of the Defense Supplies Corporation, as follows:

“They were appraised before they went in; they do not have the appraisal for these identical tires. They do, however, have records showing the amount paid

by Defense Supplies Corporation for all tires received in Northern California under the Idle Tires Program, including these tires. These figures are by graded tires and scrap tires. We propose to show the total amount paid out by Defense Supplies Corporation for this several hundred thousand tires, I think it will be that many in this area, which included these tires, and by that means and a computation made by this witness, the average value—the average amount paid by the corporation for each graded tire. I do not think there will be any dispute as to scrap tires, because they paid the same for each scrap tire.” [R. p. 117.]

Mr. Miller amplified his method of proof further as follows:

“We do not know how many of each grade, but we would like to put in evidence as to the amount the Defense Supplies Corporation paid for all of the tires, a large number in this area. We feel that the average value, the average cost or average amount paid is a fair indication of what the Defense Supplies Corporation paid for these tires.” [R. p. 118.]

Mr. McClellan testified that in his position as an employee of the plaintiff, he had access to “all of its records with respect to the tires received by the Idle Tires Program in this District, including Sacramento”, and, also, to the records showing “the amount of money paid out” by plaintiff “to owners of these tires.” [R. p. 113.]

It developed that the witness McClellan was testifying from a memorandum which he had prepared from the “original records” of the plaintiff which were kept in the Federal Reserve Bank in San Francisco, which he said showed the “number of tires of each grade included in the inventory of graded tires.” [R. p. 124.]

McClellan gave the numbers of tires received and the prices paid for them under the Idle Tires Program, for the area of Northern California. [R. pp. 124-126.]

He also testified that he knew that on April 9, 1943, the date of the fire, there were stored in the Ice Palace Warehouse 27,601 automobile tires and 1,850 tubes, but that his only sources of information as to these figures were a letter by Gordon Kenyon of the Capitol Chevrolet Company and a letter from Mr. Hanley of the Lawrence Warehouse Company. [R. p. 111.]

However, the District Court found, as stated in its opinion [R. p. 73] that plaintiff's method of computing its alleged damages was "speculative and therefore legally improper."

Therefore, the opinion looks through the transcript for morsels of evidence to serve as the basis of a judgment "within the boundaries of possibility."

In that behalf the opinion relies upon "the testimony of Alfred D. McClellan and the data contained in Plaintiff's Exhibit No. 3", to establish "the number and classification of the tires and tubes destroyed." [R. p. 74.]

The testimony of Mr. McClellan, to which the opinion refers, is that above set forth, by which the witness admitted that his only knowledge was gained from said Exhibit 3 and the letter from Hanley, so that McClellan's testimony was obviously hearsay and added nothing to the statements of the authors of the letters.

The Hanley letter was not read in evidence nor was it introduced as an Exhibit, and, as has been shown, the statements as to the number of tires and tubes contained in the Kenyon letter was purely hearsay, which fact ap-

pears on the face of the letter [R. p. 320] and by Kenyon's undisputed testimony. [R. pp. 203, 204.]

In arriving at the "fair value" of the tires and tubes, the Court's opinion employs the method of using the very plan which it condemns as "speculative" and "legally improper", to-wit, calculating the value of tires according to the average cost.

However, the Court's method lacks the merit of mathematical computation, and substitutes, pure conjecture in determining the average price paid for the graded tires, which it finds to be \$2.75 per tire although the opinion itself shows that "many of the graded tires must have been purchased at less than \$2.75" and that all of the graded used tires which required spot repairs cost 90 cents less than \$2.75 for each spot and \$1.70 less for "reinforcement or sectional repairs" and that many tire owners turned in their "poorest tires".

Hence, the opinion states that these factors "offset" and "reasonably tend to equalize", that to make the average price \$2.75 per tire, since "other tires purchased were purchased for more than \$2.75".

The opinion also adapts a method of valuation of scrap tubes which is purely speculative. The court reasons that, since there was no evidence as to O. P. A. prices and plaintiff claimed these tubes were worth 20 cents each they were probably depreciated from the value of graded tubes in the same proportion as scrap tires as compared with the value of graded tires, namely 55%. [R. p. 75.]

The amount involved is only \$198.00, but the principle employed is clearly unsound, because any one familiar with automobiles and their equipment knows that tubes are made of very different composition rubber than tires

and hence there is no logical basis for the court's assumption.

The purpose for the foregoing recital of plaintiff's attempted proof and the type of evidence relied upon by the court to evaluate plaintiff's alleged damages is to show that no "approximate accuracy" could be attained by either method.

On the other hand, it appears from the record and the testimony of plaintiff's witnesses and the statements of its counsel plaintiff had an available method of proving damages with approximate accuracy.

The two factors involved were the number of tires destroyed, which might have been established almost to the degree of precision, and the value of the tires destroyed, which could have been proved by showing the reasonable market value immediately prior to the date upon which the Idle Tires Program became effective on October 15th, 1942. [R. p. 41.]

WITH REASONABLE INDUSTRY AND ORDINARY BUSINESS ACUMEN THE NUMBER OF TIRES AND THEIR GRADES COULD HAVE BEEN PROVED.

With all of the records of the Plaintiff available, showing exactly how many tires and tubes had been purchased in the entire area, and, of course, recording the warehouse in which each tire and tube had been appraised, and, if removed to another warehouse, in which warehouse the same had been lodged, it would have been a simple although perhaps laborious process to have ascertained how many tires and how many tubes of each grade were, on the date of the fire, stored elsewhere than in the Ice Palace.

These totals having been computed, the difference between the total tires and tubes purchased and said totals

would necessarily have established the number in the Ice Palace on said date, and it was admitted by defendants that everything therein was destroyed by the fire.

Appellant insists that the transcript warrants and requires the inference that plaintiff's records must have contained all of the data necessary to the determination of both the numbers and grades of the tires and tubes and the prices paid by the plaintiff. Mr. Miller stated that the form of contract employed by plaintiff in its agreement with the Lawrence Warehouse Company, was the same as plaintiff used "in all of its agency agreements." [R. p. 110.]

Plaintiff's Exhibit 1, is the Lawrence Warehouse Company agreement. [R. p. 310, *et seq.*]. Among other stipulations within that writing, obligating the company, are the following:

"You have offered to the Defense Supplies Corporation, which is acting for the United States Government, the facilities of your warehouse for the storage of tires and/or tubes acquired by us under the 'Consumer Tire Purchase Plan'. In order to standardize our records and simplify the procedure under this Plan, you will issue receipts for tires and/or tubes delivered to you for our account by signing the appropriate section of our Form DS-T 24, one of which will accompany each lot of tires and/or tubes delivered to you. Your signature to this receipt will constitute an agreement that the tires and/or tubes are accepted by you for storage in accordance with the following conditions: * * *

2. Tires and/or tubes stored by you for the account of Defense Supplies Corporation will be segregated from all other such goods in your warehouse, and such records will be kept by you as are necessary

to identify them as the property of Defense Supplies Corporation. [R. pp. 310-311.]

3. Tires and/or tubes delivered to you for our account will be accepted by you and receipts therefor on Form DS-T 24, will be forwarded daily to Federal Reserve Bank of San Francisco, San Francisco, California. [R. p. 311.]

7. Tires and/or tubes stored by you will be delivered on the written order of Defense Supplies Corporation. It is understood that you will not be required to deliver any individual tire and/or tube either by serial number or otherwise, but that upon receipt of an order for delivery you may deliver any tire or tube in storage which is of the size, type, and classification named in order." [R. pp. 312-313.]

Hence, plaintiffs were continually informed of the whereabouts of their tires and tubes.

McClellan testified that the prices paid were the O.P.A. ceiling prices according to the grading by the appraisers, and that the original reports of the appraisers showing the grades and appraiser's evaluation were in plaintiff's possession.

Hence, without resorting to hearsay testimony, or the speculative averages method, or conjectural estimates as to one unknown quantity being an "offset" for another unknown quantity, and without guessing and assuming that two unknown quantities "tend to equalize" each other, both factors essential to establish plaintiff's damages could have been proved.¹

¹Of course appellant is not to be understood as admitting that O.P.A. ceiling prices are competent evidence to prove market value or "fair value" or "actual worth" of these articles, but both plaintiff and the court relied upon said O.P.A. ceilings to prove these inconsistent measures of damage.

III.

In Respect to the Number and Value of the Articles Involved, Finding II of the Finding of Fact Has No Support in the Evidence and Is Contrary to the Evidence.

It has been shown that the testimony of the witness McClellan concerning the sums paid by plaintiff for said articles is incompetent and valueless, and also that all of his testimony upon that question was hearsay.

No other testimony or purported evidence was adduced in plaintiff's attempt to prove substantial damage.

Assuming but not conceding that the finding of the "reasonable worth" of the "tires and tubes" stored in the "Ice Palace" Warehouse, is equivalent to finding the reasonable market value or actual value thereof, that portion of Finding of Fact II, which reads: "Plaintiff at all times mentioned in its complaint herein was the owner of said tires and tubes and entitled to their immediate possession, and said tires and tubes were on April 9, 1943, of the value of said reasonably worth the sum of \$41,-975.15." [R. p. 79], is wholly lacking in competent evidentiary support.

For the same reasons that part of Finding II which relates to the number of tires involved is entirely lacking in such evidentiary support. In fact it is almost entirely without support in the evidence, competent or otherwise, and is contrary thereto. This part of Finding II reads:

"Prior to April 19, 1943, plaintiff delivered to defendant, Lawrence Warehouse Company and to Capitol Chevrolet Company * * * at their warehouse known as the 'Ice Palace' in West Sacramento,

California, certain quantities of tires and tubes, to-wit, 27,601 tires and 1,850 tubes, for storage and safe keeping.”

Even if McClellan’s said testimony had not been hearsay and if the evidence offered to prove cost had been competent to prove market value, such testimony is so highly conjectural, contingent and uncertain as to be incompetent. McClellan did not claim that his computations were more than averages based upon speculation.

The pertinent evidence will now be set forth:

A letter written by the Chevrolet Company, dated April 10th, 1943 (after the fire), was introduced in evidence as Plaintiff’s Exhibit 3, for the purpose of showing the number of tires stored and destroyed in the Ice Palace Warehouse. [R. p. 112.] Mr. McClellan testified that this letter, which he referred to as a report in writing, showed the actual number of tires, but that the number of tubes “were estimated.” [R. p. 116.]

Mr. Miller, plaintiff’s counsel, made the following statement as his reason for asking the witness to state the total number of tires received by plaintiff from “all sources within the district, including Sacramento.” He said:

“We would like to ask this question, we can connect it up. Unfortunately, we do not have the record of the Defense Supplies Corporation as to the tires in this warehouse; the tires were being moved in at the time of the fire; they were appraised before they went in; they do not have the appraisal for these identical tires. They do, however, have records showing the amount paid by Defense Supplies Corporation for all tires received in Northern California under the Idle Tires Program, including these tires.

These figures are by graded tires and scrap tires. We propose to show the total amount paid out by Defense Supplies Corporation for this several hundred thousand tires, I think it will be that many in this area, which included these tires, and by that means and a computation made by this witness, the average value—the average amount paid by the corporation for each graded tire. I do not think there will be any dispute as to scrap tires, because they paid the same amount for each scrap tire.” [R. pp. 116-117.]

Mr. Miller said:

“There was a different amount paid. The grades of tires, as I understand it, were new, used, and re-treads. There were various grades of each. They were appraised at the ceiling price by appraisers. At the time there was no market for these tires in the legal sense of the term; they were tires taken by the government; there was no ready sale for them, because buyers were prohibited from buying unless they had the necessary OPA certificate. We are in this case unable to show what the market value of these tires was.” [R. p. 117.]

Thus it appears that plaintiff's plan and purpose was objectionable as employing a means of proof as to the number of the tires destroyed, and the amount paid for them, whose results were admittedly indefinite and speculative.¹

It is apparent, also, from the above statement that plaintiff did not expect to rely upon the letter “Exhibit 3” to fix the number of tires and tubes involved, the

¹Damages which are wholly uncertain cannot be made certain by adoption of an arbitrary standard of loss. (*Dexter Portland Cement Co. v. Acme Supply Co.*, 133 S. E. 788, 147 Va. 758.)

reason being that the statements in the letter were hearsay, even as to the Chevrolet Company. It was finally so recognized by the court. [R. p. 149.]

Mr. Miller was very frank in answering questions by the Court. He said:

“We do not know how many of each grade, but we would like to put in evidence as to the amount the Defense Supplies Corporation paid for all of the tires, a large number in this area. We feel that the average value, the average cost or average amount paid is a fair indication of what the Defense Supplies Corporation paid for these tires. It is evidence that we think should be before the court, because we are unable in this case to show what the market value was of these tires, in which event, I believe, according to law, we are permitted to put in all evidence of value which would tend to aid the court in determining what they were actually worth, because they did have a value.” [R. p. 118.]

The record shows as follows:

“Mr. Miller: We do not know how many were new tires, how many used, and how many retreads.

* * *

The Court: Do you know, Mr. Getz?

Mr. Getz: I don't know. All I can say is I don't know, but in any event we object further because it is highly speculative. There are not only different grade of different tires, but there are different prices for different sizes; there are as many sizes as there are tires made in the automobile industry. One tire of one grade may be worth \$1, and a tire of larger size in the same grade \$2 and \$3, and to attempt to get at it in this way would be highly speculative, highly prejudicial to us, because we have no way of cross-examining.

A. We did not sell them to the Rubber Manufacturers Association of America. They were our distributing agents.

Q. The price to them was less than the cost of the Defense Supplies Corporation, was it not? A. We did not sell them to the R. M. A. A.

Q. Did you fix a price at which they could resell them for you? A. I believe we did.

Q. Wasn't it less than the price which you paid for them? A. I could not say." [R. p. 119.]

The witness then testified that there were six grades of tires; that the "lowest grade in the smallest size had an appraised value of \$2.75," and that "would be the lowest grade tire." He said that the "highest grade of the largest tires" was appraised at "anywhere from \$12 up to \$25." [R. p. 120.]

The complaint asked for \$76,000 damages for the tires alleged to have been burned. Mr. Miller said "this was based on a price of \$3.48 for each graded tire, being the average paid" by plaintiff "for all graded tires received in the program in Northern California." [R. p. 122.]

The court then advised counsel, as follows:

"I will allow all of the testimony to go in as to the prices that you paid, and the prices that you appraised the tires for each grade, and then we can determine at a later date whether it would be proper as a matter of law whether the Court can properly consider it anything more than the lowest appraisal." [R. p. 121.]

The following observations were made:

"Mr. Wallace: If your Honor please, I would like, for the purpose of the record, to make one further

objection, which is based upon the testimony of this witness, that he does not know whether or not the Defense Supplies Corporation sold all of the tires they bought at a fixed price which was substantially lower than the price at which they purchased them, and I think, under the circumstances, the market value, that is what the witness is attempting to do, would be reflected by the price at which they sold, not the price at which they purchased; so these figures get even more remote from establishing any kind of a market value.

Mr. Miller: I must say that so far as saying that the amount which Defense Supplies Corporation sold these tires was the market price, that certainly, in my opinion, is not legally the market price in the sense that we understand the term 'market value.'

The Court: Counsel, I do not want to get into an argument of this case now. There is nothing in the record as yet as to what factors should be taken into account in determining the value of these tires."
[R. p. 123.]

Mr. Miller next attempted to show what plaintiff paid for the tires, and his questions brought forth the following information from Mr. McClellan:

In the district of Northern California 545,006 tires were received, of which 283,857 were graded and 239,820 were scrap tires. \$989,191.41 were paid for the graded tires. [R. p. 124.]

McClellan admitted that as to four of the six grades of tires shown in plaintiff's records grades 1, 2, 3 and 4 were merely "graded as a total," the total being 279,933 for which plaintiff paid \$942,197.43. It paid \$18,011.38 for .988 new tires and \$28,982.60 for \$2,938 retreads,

and \$49,719.00 for scrap tires, at 20 cents each. [R. p. 125.]

McClellan said that in the whole area 7,133 tubes were received; that 385 were new, for which \$1,336.14 was paid, and \$9,934.80 was paid for the used tubes. [R. p. 126.]

Thus, the conjectural character of the testimony is accentuated by the lumping of grades 1, 2, 3 and 4 so that, as to them, any attempted averaging on the guess-work theory that the averages were stored in the Ice Palace is further weakened by the uncertainty that this is true as well as the uncertainty that the tires there stored were numerically, by different priced grades, the net average for the whole area of Northern California.

Mr. Miller then, over the original objections by attorneys for appellant and the Lawrence Warehouse Company² was permitted to introduce a document, which Mr. McClellan testified was a copy of OPA ceiling prices in effect during the period involved as "Plaintiff's Exhibit 5."

Also, said last mentioned attorneys added to the objection first made by Mr. Wallace that: "Counsel is attempting to show, as I assume, the value of particular tires by showing average prices throughout a very large area for a very large number of buyers, which is too remote and too speculative to determine value of particular tires." [R. p. 133.]

²It was understood that the objections originally made extended to that entire line of testimony. [Tr. 131-133.]

Mr. McClellan testified that the appraisers were instructed to follow this price list in valuing the tires. [R. p. 130.] No appraiser was called to testify that he followed such instructions.

The plaintiffs also introduced evidence as to transportation costs and storage payments, which the court ruled was incompetent. [R. pp. 134-136.]

On cross-examination, in answer to questions by Mr. Wallace, the witness testified that the appraisal of the tires was made by appraisers appointed by plaintiff, with which the warehouse had nothing to do [R. p. 147]; and the witness admitted that he had no personal knowledge of "how many tires in that warehouse were graded"; that all he knew about that was what was reported in the letter, Plaintiff's Exhibit [R. p. 148.]

That the court recognized that the Chevrolet Company letter was purely based on hearsay, is shown as follows:

"Mr. Wallace: I think that is sufficient. The point I make about it is as far as the warehouse company is concerned that reference in the letter as to grading was pure hearsay on the part of the Capitol Chevrolet Company, because they neither graded or appraised the tires.

The Court: I understand they got the information from appraisers.

Mr. Wallace: I do not think there has been any evidence on that, at all.

The Court: Clear it up if you wish to.

Mr. Wallace: I take it that this witness testified that he does not know anything about it except the information which he got from the letter." [R. p. 149.]

McClellan testified as to the reports of the original appraisers as follows:

“A. We have a report on each tire appraised, but they are filed in such a manner that it would be difficult if not impossible to segregate them. We have the individual appraisements and reports.

Q. But is there any way you can, from your reports, tell us (a) what tires were in that warehouse, and (b) how they were appraised, and (c) what class they were in, what grade? A. No, there is not, because the minute it was appraised it lost its original identity.

Q. So there is no way you can tell us from your records what tires were in the warehouse, what the grade of those tires was, and how much they were appraised, or what stores they were in? A. No.”
[R. pp. 149-150.]

Let us pause and appraise the situation as presented up to this point. When the appraisals were made by plaintiff's employees, if they were following instructions the OPA price ceilings were made the basis of the appraisements. The appraisers apparently make reports showing the items of tires and tubes taken from owners and appraised, the grades of each item, its type and the price allowed the owner.

However, McClellan swore, the “minute” the appraisers' reports were filed in plaintiff's office, each one “lost its original identity,” the result being that by reason of plaintiff's inept and typically beaurocratic method of conducting the Government's business, plaintiff “had no way” by which, “from its records,” it “could prove in court,” what “the grade of those tires was,” or “how much they were appraised, or what stores they were in.”

It seems inconceivable that any one, representing a private concern or individual, would even ask a court to render a judgment for damages for loss of property based on a claim made in a complaint that the articles allegedly lost were stored in a certain warehouse, knowing that he could not prove that any article was ever stored there; that he could not even prove the value of any article, even as appraised by his client's own employees, and that he had no way of showing that the articles which in some manner had become missing had any one of four possible values.

As far as this record shows by plaintiff's own proof and the statements of its attorney, its only reason for suing appellant and the Lawrence Warehouse Company was that plaintiff had stored an unknown number of tires and tubes in the Ice House Palace; that a fire occurred there and a large number of plaintiff's tires and tubes are missing.

This Government Agency calmly and confidently announced that it had dumped \$76,000 worth of Uncle Sam's tires and tubes within the walls of a warehouse, neither retaining an inventory nor requiring a receipt or any memoranda of the property.

This Agency also, with equal assurance, revealed to the Court that in buying the tires and tubes, it deliberately effaced every means by which defalcations, thefts, incompetence, gross carelessness or graft of its appraisers or others employees could become known or be proved.

That the trial judge properly foresaw the difficulties and his responsibilities is apparent from the unusual course pursued. Although from the beginning it was plain that McClellan's testimony would all be based on

hearsay and that damages would be fixed upon a purely arbitrary standard the Court received the testimony unhesitatingly, subject to all defense objections.

Thus, we see the situation at the point when appellant's attorney, Mr. Getz, took over the cross-examination of the witness McClellan.

The witness at once admitted that according to the price list furnished appraisers, used tires might have been appraised and have cost as little as 90 cents or even 75 cents each because of deductions for needed repairs. He admitted that "a percentage of all used tires were 'in bad shape'; that people in selecting the tires which they were compelled to sell usually kept the best and 'turned in the worst they had.' "

McClellan admitted that by reason of this factor, there was no way of determining what was actually paid by plaintiff for the "\$14,000 graded tires which were claimed to have been in the 'Ice Palace.' " [R. pp. 150-151.]

He also admitted that this factor might have "varied from 90 cents on up to the highest price."

McClellan, for the first time, testified that the plaintiff paid the owner whatever price the appraiser placed on tires. He also admitted that the original grades as appraised were afterward often regraded, up or down, in selling or disposing to dealers or turning them over to R. M. A. A.

Thus, two more elements of uncertainty were added to the confusion and qualifications already existing.

Mr. McClellan asserted that he did not know whether the prices which his list contained were different when sold to wholesalers than when sold to retailers, and that his list was "the retail prices."

It requires only common knowledge and common sense to know that no wholesaler would pay the retail ceiling price, which would necessarily mean that he must lose all handling costs and make no profit.

Since the R. M. A. A. was an agent of the plaintiff [R. p. 153], whether sold through said agent or directly to dealers, plaintiff necessarily sold at a loss, because no dealer could pay ceiling prices and resell without loss at the same prices.

Hence, plaintiff's actual loss, when a tire or tube was destroyed, was less than the price paid, but no one testified how much this margin was.

On redirect examination, if that were possible, the situation from plaintiff's point of view was further muddled.

McClellan testified that the tires were substantially all delivered graded to the Ice House Palace; that 580 tires were delivered there direct from owners by Railway Express and whether these were ever graded, he failed to state. [R. pp. 155-157.]

However, since as the witness had testified that the tires were sometimes regraded at the warehouse where they were first received, and before payment for them was made, by the time the tires were stored in the Ice House Palace, an "unknown percentage" of them had been graded up or down from the original appraisement list, a copy of which was the basis of McClellan's hearsay testimony.

Conclusion.

A Government corporation is in the same category as a private corporation and has no greater right than a private corporation. This has been the holding of the Supreme Court of the United States and it should govern this case.

We respectfully submit there is absolutely no proof of negligence on the part of the Capitol Chevrolet Company, or of any appellant, and the judgment should be reversed upon this ground alone.

Among other grounds for reversal are the construction of the law relating to the measure of damage in which we respectfully submit that the Court erred.

We pray for reversal of the judgment upon each of the grounds presented by this appeal.

Respectfully submitted,

MORRIS LAVINE,

Attorney for Capitol Chevrolet Company.

No. 11,418

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

LAWRENCE WAREHOUSE COMPANY
(a corporation),

Appellant,

VS.

DEFENSE SUPPLIES CORPORATION,

Appellee.

CAPITOL CHEVROLET COMPANY
(a corporation),

Appellant,

VS.

DEFENSE SUPPLIES CORPORATION,

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V. J. McGREW,

Appellant,

VS.

DEFENSE SUPPLIES CORPORATION,

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DEFENSE SUPPLIES CORPORATION,

Appellant,

VS.

CLYDE W. HENRY,

Appellee.

FILED

AUG 13 1947

PAUL P. O'BRIEN,
CLERK

BRIEF FOR APPELLEE, DEFENSE SUPPLIES CORPORATION, IN REPLY TO BRIEFS FOR APPELLANTS, LAWRENCE WAREHOUSE COMPANY, CAPITOL CHEVROLET COMPANY AND V. J. McGREW.

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Subject Index

	Page
Jurisdictional statement	2
Statement of the case	2
A. The facts	2
B. The issues raised by the appellants	4
1. Issues raised by appellant Capitol Chevrolet Com- pany	4
2. Issues raised by appellant Lawrence Warehouse Company	5
3. Issues raised by appellant V. J. McGrew.....	5
Argument on case against Capitol Chevrolet Company.....	6
1. Appellant Capitol Chevrolet Company is liable to ap- pellee for the loss sustained as a result of Capitol's negligence	6
2. There is substantial evidence to support the finding of negligence on the part of Capitol Chevrolet Com- pany	8
3. Appellee was not guilty of contributory negligence....	16
4. In any event the argument of Capitol on the suffi- ciency of the evidence merely goes to the weight of the evidence and the negligence of appellants is a question of fact for the determination of the trial court	18
5. There was sufficient competent evidence to support the amount of damages fixed by the court.....	19
Argument on case against Lawrence Warehouse Company...	26
1. There is substantial evidence to support the finding of negligence on the part of Lawrence.....	26
2. There is substantial evidence to support the finding that the damage was proximately caused by the neg- ligence of Lawrence	29
Argument on case against V. J. McGrew.....	31

	Page
1. This court has no jurisdiction over the appeal of McGrew	31
2. There is substantial evidence that McGrew caused the fire by the negligent use of the acetylene torch.....	32
Conclusion	36

Table of Authorities Cited

Cases	Pages
Armory v. Delamirie, 1 Strange 504, 1 Smith's Leading Cases 679	24
Atwood v. So. Cal. Ice Co., 63 Cal. App. 343.....	11
Bartholomai v. Owl Drug Co., 42 Cal. App. (2d) 38.....	35
California Orange Co. v. Riverside P. C. Co., 50 Cal. App. 522	25
Charles Nelson Co. v. Pacific Wharf & Storage Co., 58 Cal. App. 347	19
Diaz v. United States, 223 U. S. 442, 450	20
E. N. Emery Co. v. American Refrigerator Transit Co., 189 N. W. 824 (Ia.)	6
Eastman Co. v. So. Photo Co., 273 U. S. 359.....	22
England v. Lyon Fireproof Storage Co., 94 Cal. App. 562..	11
Falk v. Falk, 48 Cal. App. (2d) 762.....	20
Fox v. Hale & Norcross S. M. Co., 108 Cal. 369.....	24
Gerhart v. Southern Cal. Gas Co., 56 Cal. App. (2d) 425..	34
Giles v. Moundridge Milling Co., 173 S. W. (2d) 745 (Mo.)	8
Gulf Insurance Co. v. Temple, 187 So. 814 (La.).....	10, 13
Haeker, etc. Co. v. Chapman V. Mfg. Co., 17 Cal. App. (2d) 265	25
Hanlon D. & S. Co. v. Southern Pac. Co., 92 Cal. App. 230..	22, 24
International SS Co. v. Fletcher Co., 296 Fed. 855 (C.C.A. 2)	12
Judson v. Giant Powder Co., 107 Cal. 549, 40 Pac. 1020...	34
Lake Union Dry Dock & Machine Works v. U. S., 79 Fed. (2d) 802 (C.C.A. 9)	10
Lancashire Shipping Co. v. Moore Dry Dock & Repair Co., 43 Fed. (2d) 750 (D.C. N.Y.).....	12

	Pages
Larson v. Union Investment & Loan Co., 10 P. (2d) 557 (Wash.)	24
Lindor v. Burns, 10 N. E. (2d) 686 (Ill.).....	10, 13
Mosley v. Arden Farms, 26 Cal. (2d) 213.....	31
Newport News v. U. S., 34 Fed. (2d) 100 (C.C.A. 4).....	10
Olsen Water & Towing Co. v. U. S., 21 Fed. (2d) 304 (C.C.A. 2)	13
Pac. Steam Whaling Co. v. Alaska Packers Association, 138 Cal. 632	22
Pye v. Eagle Lake Lumber Co., 66 Cal. App. 584.....	24, 25
Reliance Insurance Co. v. Pohlking, 19 N. E. (2d) 906 (Ohio)	34
Rilovich v. Raymond, 20 Cal. App. (2d) 630.....	22
Royal Insurance Co. v. Collard Motors, 179 So. 108 (La.)..	10
Runkle v. Southern Pacific Milling Co., 184 Cal. 714. .	11, 17, 18, 29
Salt River Valley Water Users Association v. Cornum, 63 Pac. (2d) 639	29
Sauntry v. U. S., 117 Fed. 132 (C.C.A. 8).....	25
Seymour v. Oelrichs, 156 Cal. 782	25
Story Parchment Co. v. Paterson Co., 282 U. S. 555, 75 L. ed. 544	22, 25
Taylor v. Oakland Scavenger Co., 17 Cal. (2d) 594.....	30, 31
Tide Water Oil Co. v. Brewer Dry Dock Co., 54 Fed. (2d) 139 (D.C. N.Y.)	13
Travellers Fire Ins. Co. v. Brock & Co., 30 Cal. App. (2d) 112	11
U Drive & Tour v. System Auto Parks, 28 Cal. App. (2d) (Supp.) 782	11
U. S. v. Todd-Engineering Dry Dock Co., 53 Fed. (2d) 1025 (D.C. La.)	12

	Page
Walter v. Sanders Motor Co., 294 N. W. 621 (Iowa).....	10
Walters v. Adams Transportation & Storage Co., 141 S. W. (2d) 205 (Mo.)	10
Walters v. Balt. & Ohio Railroad Co., 76 Fed. (2d) 599....	32
Westover v. City of Los Angeles, 20 Cal. (2d) 635.....	31
White v. Spreckels, 10 Cal. App. 287, 101 Pac. 920.....	34
Wilson v. Crown Transfer & Storage Co., 201 Cal. 701....	11

Statutes

California Warehouse Receipts Act, Sec. 21, Deering's Gen- eral Laws, Act 9059	26
Civil Code:	
Section 1858c	26
Section 2338	26
28 U. S. C., Sections 41(1) and 42	2
28 U. S. C., Section 225, Subdivision (a), Subsection First	2
28 U. S. C. A., Section 230	32

Texts

78 A. L. R. 858, note	24
19 Cal. Jur. 572	29
19 Cal. Jur. 649, Section 78	17
19 Cal. Jur. 704, et seq.	34
3 C. J. S. 130, Section 221	7
8 C. J. S. 348-9	10
25 C. J. S. 494-6, 815	24
10 Cyc. of Federal Procedure, Section 5176	32
1 Mechem on Agency, 2d ed. Section 1460	7
1 Mechem on Agency, 2d ed. Section 1460, p. 1082	7
2 Restatement of the Law of Agency, Section 354.....	8
2 Sutherland (4th ed.) 1414-15	24
4 Sutherland (4th ed.) 4224-25	24
1 Wigmore on Evidence, Third Edition, 321	20

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CLYDE W. HENRY,

Appellee.

BRIEF FOR APPELLEE, DEFENSE SUPPLIES CORPORATION, IN REPLY TO BRIEFS FOR APPELLANTS, LAWRENCE WAREHOUSE COMPANY, CAPITOL CHEVROLET COMPANY AND V. J. MCGREW.

JURISDICTIONAL STATEMENT.

This is a civil action. The amount in controversy exceeds \$3,000 exclusive of interest and costs.

The jurisdiction of the District Court was conferred by reason of the amount in controversy and by reason of Sections 41(1) and 42 of Title 28 of the United States Code, the Government of the United States being the owner and holder of more than one-half of the capital stock of appellant Defense Supplies Corporation, a federal corporation created by and organized under an act of Congress of the United States. (Complaint, Tr.* pp. 3 and 4.)

This Court has jurisdiction on appeal under Section 225, Subdivision (a), Subsection First, Title 28, United States Code.

STATEMENT OF THE CASE.

A. THE FACTS.

Appellee Defense Supplies Corporation, a corporate agency of the United States, in 1943 initiated and prosecuted a plan known as the "Idle Tire Purchase Plan", the purpose of which was to create a stock pile of used and new automobile tires and tubes in aid of the National Defense Program. On March 1, 1943, it entered into a contract with appellant Lawrence Warehouse Company, a corporation engaged in the warehousing business, for the storage and safekeeping of the tires and tubes that had been accumulated in Sacramento, California. Lawrence Warehouse Company with the consent and approval

*Throughout this brief the designation "Tr." refers to the printed transcript of the record on appeal.

of appellee Defense Supplies Corporation in turn contracted with appellant Capitol Chevrolet Company, a corporation, to warehouse the tires and tubes as the agent for Lawrence.* Capitol Chevrolet Company, in furtherance of the plan for storage and safekeeping of the tires and tubes, leased from appellee Clyde W. Henry and Constantine Parella a building owned by them near the City of Sacramento, California, formerly used as an ice skating rink, and commonly known as the Ice Palace.

On April 9, 1943, appellant V. J. McGrew, who was engaged in the drilling of a water well for Clyde W. Henry, entered the engine room of the Ice Palace for the purpose of removing therefrom a steel tank owned by Henry. He was assisted in the work of removing the tank by Charles Elmore, an employee of Henry. The steel from the tank was to be used by McGrew in lining the water well which he was drilling for Henry. While McGrew was using an acetylene torch in cutting up the steel tank, a fire started in the engine room and spread to the main building where the tires and tubes were stored, and all of the tires and tubes were destroyed by the fire.

Appellee Defense Supplies Corporation filed suit for the loss sustained as a result of the fire, in the United States District Court for the Northern District of California, Southern Division, against Lawrence Warehouse Company, Capitol Chevrolet Company, Clyde W. Henry,

*Throughout this brief appellants Lawrence Warehouse Company, Capitol Chevrolet Company and V. J. McGrew will sometimes be referred to as "Lawrence", "Capitol" and "McGrew", respectively, and appellee Clyde W. Henry will sometimes be referred to as "Henry", for convenience. The word "appellee" will refer to appellee Defense Supplies Corporation unless the name Clyde W. Henry is used with it.

Constantine Parella, V. J. McGrew, and Charles Elmore. (Tr. p. 3, et seq.) On the trial at the close of plaintiff's case the action was dismissed as to the defendants Constantine Parella and Charles Elmore without opposition by appellee. (Tr. pp. 307, 308.) The other defendants then moved for dismissals and the case was submitted on these motions, no evidence on behalf of any of the defendants having been offered. The trial Court gave judgment in favor of Defense Supplies Corporation against defendants Lawrence Warehouse Company, Capitol Chevrolet Company, and V. J. McGrew. Each of these defendants has appealed to this Court. The trial Court granted the motion of defendant Clyde W. Henry and gave judgment of dismissal in his favor. Appellee Defense Supplies Corporation has appealed from this judgment and this appeal is now pending herein. (See separate briefs for appellant Defense Supplies Corporation and appellee Clyde W. Henry.)

On February 28, 1947, the Court, on stipulation of the parties, ordered the consolidation of the appeals of appellants Lawrence Warehouse Company, Capitol Chevrolet Company and V. J. McGrew, for briefing purposes and authorized appellee Defense Supplies Corporation to file a single brief in answer to all opening briefs of said appellants. This is the reply to the briefs of each of said appellants.

B. THE ISSUES RAISED BY THE APPELLANTS.

1. Issues raised by appellant Capitol Chevrolet Company.

The brief of appellant Capitol Chevrolet Company sets forth four specifications of error upon which the appel-

lant relies. These specifications of error raise the following issues:

(a) That Capitol is not liable to appellee as a matter of law because an agent is not liable to a third person for a violation of its duty to its principal.

(b) That the evidence is insufficient to support the finding of negligence on the part of appellant Capitol Chevrolet Company.

(c) That in any event appellee Defense Supplies Corporation was guilty of contributory negligence.

(d) That the amount of damages fixed by the Court is not supported by the evidence.

2. Issues raised by appellant Lawrence Warehouse Company.

(a) That the evidence is insufficient to support the finding of negligence on the part of the appellant Lawrence Warehouse Company.

(b) That the evidence is insufficient to support the finding that the fire and loss of the appellee's goods was proximately caused by the negligence of Lawrence Warehouse Company.

3. Issues raised by appellant V. J. McGrew.

The specifications of error contained in this appellant's brief state in different ways the single issue raised by him. That issue is that the evidence is insufficient to support a finding that the fire and loss of appellee's goods were caused by the use of the torch by McGrew. We believe that this Court cannot hear the appeal of this appellant because it was filed too late. However, we include a brief

discussion of the issue raised with the thought that it may be of assistance to the Court in deciding the case as a whole.

**ARGUMENT ON CASE AGAINST CAPITOL CHEVROLET
COMPANY.**

1. **APPELLANT CAPITOL CHEVROLET COMPANY IS LIABLE TO APPELLEE FOR THE LOSS SUSTAINED AS A RESULT OF CAPITOL'S NEGLIGENCE.**

Capitol cannot escape liability by virtue of the fact that it was acting as agent for Lawrence Warehouse Company. It is true that the Courts sometimes speak of the principle that an agent is not liable to third parties for a violation of its duty to the principal. This is true, however, only where there has been no breach of a duty to the third party. In the present case the goods of appellee were entrusted to Capitol and it owed a duty to appellee to use due care for the protection of its goods. In such cases where loss results from the negligent act or omission of the agent, the agent is liable. This was pointed out by the trial Court in its opinion. (Tr. p. 73.) Thus, in the case of *E. N. Emery Co. v. American Refrigerator Transit Co.*, 189 N. W. 824 (Ia.) which is one of the cases cited by the trial Court, the Court stated as follows:

“* * * The question involved is an old one concerning which there is much conflict of authority. The difficulty lies in determining whether the agent owes a duty to a third person. Liability is predicated on duty. If the agent is put in control of the situation with the express or implied consent of the principal, or is given or exercises such powers within his au-

thority that an independent actor would have, it is quite generally held that he owes a duty to third persons to use due care in what he does, the same as any other individual. Such a control of property imposes upon him a duty, not altogether and simply as agent, but as a custodian and controller of such property for the purposes in hand. The fact that he also owes a special duty to his principal is not material.” (p. 828.)

The general rule has been stated by Professor Mechem as follows:

“So if an agent or servant, while acting upon his master’s business, so negligently acts as to cause direct and immediate injury to the person or property of a third person, whether he be one to whom the master owes a special duty or not, under circumstances which would impose liability on the agent or servant, if he were acting under the same conditions on his own account, he will be personally liable. * * *”
1 *Mechem on Agency*, 2d ed. sec. 1460.

See also 3 *C.J.S.* 130, Sec. 221, and the cases there cited.

Professor Mechem points out that in many cases it is more convenient to proceed against the principal but that this does not mean the agent is not liable. See 1 *Mechem on Agency*, 2d ed., sec. 1460, p. 1082, where it is said:

“* * * The liability of the servant is the direct and primary one; that of the master is a secondary and imputed one. In actual practice, the liability of the servant or agent is usually ignored because it is more convenient or effective to pursue the master, but the servant’s liability nevertheless exists. * * *”

Here Capitol Chevrolet Company has undertaken the storage and protection of goods and has failed to protect them. It cannot escape liability on the ground that it was acting only as an agent.

2 Restatement of the Law of Agency, sec. 354.

The fact that Capitol may not have had complete control of the goods to the exclusion of its principal is not material so long as its control extended to the cause of the loss.

Giles v. Moundridge Milling Co., 173 S. W. (2d) 745 (Mo.).

2. THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE FINDING OF NEGLIGENCE ON THE PART OF CAPITOL CHEVROLET COMPANY.

Appellant Capitol Chevrolet Company next argues that there is no evidence to support the finding of negligence on its part. It bases its argument in this respect on the contention that the evidence discloses the following factors which operate to relieve Capitol of all responsibility:

A. The evidence discloses that the appellee itself selected and approved the premises where the goods were stored.

B. The premises were properly equipped with fire-fighting equipment.

C. Appellee had undertaken a "joint custodianship" with Lawrence Warehouse Company for the storage of the goods.

In answer to Capitol's argument we will take each alleged factor in the above order.

A. The fact that appellee approved the premises as fit for the storage of the tires and tubes cannot relieve Capitol from the duty to exercise due care. It is true, as Capitol points out in its brief, that appellee authorized it to use the premises for storage purposes and appellee's counsel so stipulated at the trial. (Tr. p. 111.) This perhaps would relieve Capitol from responsibility if the loss had been caused by reason of a known defect in the premises. It cannot operate, however, to permit Capitol to be careless in its protection of the goods. Here the loss was caused by the use of an acetylene torch on the premises. It was Capitol who permitted the use of the torch and failed to take proper precautions under the circumstances. There is nothing in the evidence to indicate that appellee approved either the use of the torch or the precautions taken, and no such contention is made. We know of no authority, and none is cited, which supports Capitol's proposition that approval of the premises by a bailee will make proper safeguarding of the stored goods by the bailor unnecessary.

B. There is no evidence that the premises were properly equipped with fire-fighting equipment under the circumstances. Capitol argues that because the evidence shows that there was a hydrant at each corner of the building the premises were properly equipped and Capitol was not negligent in this respect. Capitol then argues that no one testified that the hydrants were not available or properly equipped. Appellee did not have the burden of proving Capitol's case. The evidence shows that the hydrants were not used at the start of the fire, and also that there was no fire-fighting equipment in the room

where the fire started other than a five-gallon bucket of water placed there by the workmen who used the torch. (Tr. p. 219.) The bucket was in fact ineffectual to put the fire out. No evidence was offered by any of appellants to show that the equipment was proper or that the precautions taken were such as would have been taken by a reasonably prudent man under the circumstances.

When it is shown that the bailed goods were destroyed by a cause within the control of the bailee, an inference of negligence is raised which places the burden on the bailee to show the exercise of due care on its part.

Thus, when the goods are destroyed by fire and it is shown that the fire was started by a means or in a place under the control of the bailee, then the bailee is liable, unless it shows by affirmative evidence that it used due care.

Lake Union Dry Dock & Machine Works v. U. S.,
79 Fed. (2d) 802 (C. C. A. 9);

Newport News v. U. S., 34 Fed. (2d) 100 (C. C. A.
4);

Lindor v. Burns, 10 N. E. (2d) 686 (Ill.);

Gulf Insurance Co. v. Temple, 187 So. 814 (La.);

Royal Insurance Co. v. Collard Motors, 179 So. 108
(La.);

Walter v. Sanders Motor Co., 294 N.W. 621 (Iowa);

Walters v. Adams Transportation & Storage Co.,
141 S.W. (2d) 205 (Mo.).

See also the comments in 8 *C. J. S.* 348-9. It is there pointed out that some recent cases go further and hold that the bailee must show lack of negligence even where

there has been no showing that the cause was within the bailee's control.

The California cases support the general rule and hold that a bailee must produce evidence of lack of negligence on its part.

Wilson v. Crown Transfer & Storage Co., 201 Cal. 701;

Runkle v. Southern Pacific Milling Co., 184 Cal. 714;

Atwood v. So. Cal. Ice Co., 63 Cal. App. 343;

Travellers Fire Ins. Co. v. Brock & Co., 30 Cal. App. (2d) 112;

U Drive & Tour v. System Auto Parks, 28 Cal. App. (2d) (Supp.) 782;

England v. Lyon Fireproof Storage Co., 94 Cal. App. 562.

In the *Runkle* case, *supra*, the Court said, at page 721:

“While it was incumbent upon the plaintiff to sustain the burden of showing defendant's negligence, it was not necessary to the plaintiff's case to show affirmatively what would constitute ordinary care on the part of the defendant in the operation and management of its warehouse. That was a matter of defense, and in the absence of a showing in that behalf by the defendant it was within the province of the jury to determine from all of the evidence whether the defendant was negligent in the management of its business or conducted it with the care and caution which would, considering the character of the business, ordinarily be required of a reasonably prudent person.”

In the present case the cause of the destruction of plaintiff's goods has been shown, but there is no showing that proper precautions against the origin and spread of

the fire were taken. Here the plaintiff has gone further and has shown additional facts indicating negligence on the part of the bailee. For instance the evidence shows that there was no fire-fighting equipment in the room where the fire started, other than a five gallon bucket of water taken there by the workmen. (Tr. p. 219.) It also shows that the workmen were permitted to go on the premises in violation of the expressed written instructions of the plaintiff. (Plaintiff's Exhibits 9, 10 and 13, Tr. pp. 339, 340 and 350.) The fact that such additional circumstances are shown, however, should not relieve the warehouseman or its agent from the necessity of showing that adequate precautions against fire were taken. As the evidence stands, they took no precautions whatever in spite of the fact that they permitted an extremely hot flame to be used in a frame building close to where inflammable rubber was stored.

It has been held that the use of an acetylene torch near inflammable material is itself negligence.

International SS Co. v. Fletcher Co., 296 Fed. 855
(C. C. A. 2).

It has also been held that the use of such a torch without examining the premises for inflammable material and taking customary safeguards against fire is gross negligence.

U. S. v. Todd-Engineering Dry Dock Co., 53 Fed.
(2d) 1025 (D.C. La.);

*Lancashire Shipping Co. v. Moore Dry Dock &
Repair Co.*, 43 Fed. (2d) 750 (D.C. N.Y.).

And it has been held in a number of cases that the use of an acetylene torch on the bailee's premises renders the

bailee liable for the resulting damage to the bailor's property in the absence of affirmative evidence that proper and customary precautions were taken.

Lindor v. Burns, 10 N.E. (2d) 686 (Ill.);

Gulf Insurance Co. v. Temple, 187 So. 814 (La.);

Olsen Water & Towing Co. v. U. S., 21 Fed. (2d) 304 (C. C. A. 2);

Tide Water Oil Co. v. Brewer Dry Dock Co., 54 Fed. (2d) 139 (D.C. N.Y.).

C. There is no evidence of a "joint custodianship". Capitol's argument in this respect is with the apparent purpose of showing that it had no control over the appellee's goods, and that, therefore, it should not be held responsible for their loss. The evidence is clear, however, that the obligation of caring for the goods rested in Capitol, the actual custodian. The relationship between the parties is set forth in written agreements admitted in evidence. (Plaintiff's Exhibit 1, Tr. p. 310, and Plaintiff's Exhibit 11, Tr. p. 341.) The provisions of these agreements are clear. Appellant Lawrence Warehouse Company agreed to store the tires and tubes delivered to it by Defense Supplies Corporation at a fixed charge per tire or tube, and further agreed that its "general responsibility for the care and protection of the tires will be limited to such care as is required by laws governing warehouses in [its] state and to the exercise of ordinary care on [its] part." Appellant Capitol Chevrolet Company agreed with appellant Lawrence Warehouse Company to receive such tires and tubes as may be delivered to it for the account of Lawrence Warehouse Company and "to store and safeguard the storage of such tires and

tubes as are received by Capitol Chevrolet Company.” Capitol attempts to infer from the evidence a different relationship than is set forth in the written agreements and seldom mentions the agreements themselves. It is our opinion that the written agreements can not be avoided in this manner and in fact appellant makes no argument and cites no cases in support of its position in this respect. It tries to avoid the agreements by ignoring them.

In attempting to show that appellee had control over the premises, Capitol emphasizes the arrangement made with Burns Detective Agency. Appellee requested Lawrence Warehouse Company to install a 24-hour guard service at the premises, and accordingly Lawrence Warehouse Company arranged with Burns Detective Agency for this service. Capitol contends that the Burns guards were employees of appellee. In support of this contention it relies on a statement made by counsel for appellee at the trial. This statement is as follows:

“We will stipulate that the guards were employees of the Burns Detective Agency; that arrangements were made with the Burns Detective Agency by the Lawrence Warehouse Company at the request of the Defense Supplies Corporation; that the Burns Detective Agency was paid by Lawrence Warehouse Company, and that Defense Supplies Corporation reimbursed the Lawrence Warehouse Company for the cost of the guard service. Is that correct?” (Tr. p. 285.)

We think that the statement sets forth clearly the true arrangement and certainly can not give rise to an infer-

ence that the guards were employees of appellee. Furthermore, Kissell, one of the Burns guards, testified that he permitted the workmen to enter the premises *upon orders from Capitol Chevrolet Company*. Kissell testified as follows (Tr. p. 280):

“Q. You say there was an order. What do you mean by that?

A. There was an order came from the Capitol Chevrolet Company permitting Mr. Henry to remove this stuff from the engine room.

Q. Did that appear in your book of instructions, or whatever you kept there?

A. That was our orders, not to let anything be moved from the premises unless there was an order from the Capitol Chevrolet Company.”

Also, Mr. Gordon Kendon, the assistant manager of Capitol Chevrolet Company, testified that he gave the workmen permission to enter the premises. In the face of this testimony it seems idle for Capitol to argue that it had no control over the premises. It clearly appears that Capitol was in control and was directly responsible for permitting the use of the torch.

Capitol further contends that the evidence shows that appellee had control over admissions to the premises and such control was sufficient to relieve Capitol from responsibility.

It is true that appellee authorized certain persons to enter the premises. (Plaintiff's Exhibit 10, Tr. p. 199.) This is not inconsistent with a bailor-bailee relationship. In the ordinary bailment case the bailee has the right to designate the persons other than the bailor to whom the

goods are available for inspection or removal. The difficulty with Capitol's position is the conclusion that this right on the part of the bailee is inconsistent with the right of the bailor to care for the stored goods, for there is no such inconsistency. There is nothing in the evidence to indicate that appellee assumed any control over the safeguarding of the goods from loss by fire to the exclusion of the custodian of the goods. The record is devoid of evidence to indicate that Capitol could not take whatever precautions it deemed advisable to protect the goods from fire.

Capitol's position is a unique one. It had agreed to store and safeguard the goods, and now seeks to avoid liability on the ground that it was not storing the goods at all because it had no control over the premises. One is tempted to ask, "What was Capitol being paid for?" Certainly the fact that appellee requested guard service and authorized certain persons to enter the premises does not show that appellee had such exclusive control over the care of the goods as would relieve Capitol from responsibility.

3. APPELLEE WAS NOT GUILTY OF CONTRIBUTORY NEGLIGENCE.

The fact that appellee approved the storage site and requested the guard service can not, as Capitol contends, prevent recovery by appellee, because even assuming that these acts constitute negligence, which we do not admit, they had nothing whatever to do with the cause of the loss. It is elemental, of course, that in order that the negligence of plaintiff may release defendant from lia-

bility such negligence must contribute proximately to the injury complained of.

19 *Cal. Jur.* 649, Section 78.

Here the causes of the loss were the use of a torch, and the failure of Capitol to take proper safeguards. Appellee had nothing to do with these acts. It knew nothing of the use of the torch until after the fire, and did nothing to approve the use or to prevent the taking of proper safeguards.

Capitol cites in its brief some early cases from other jurisdictions purporting to hold that where a bailor has knowledge of conditions under which the goods are stored he can not recover for the loss due to such conditions. This may be true where the injury is caused by a defect in the premises known and approved by the bailor. Such knowledge, however, can not operate to relieve the bailee from liability for its negligence in the care of the goods.

Runkle v. So. Pac. Milling Co., 184 Cal. 714.

In the *Runkle* case there was inadequate fire-fighting equipment in view of the nature of the warehouse and the goods stored therein, and as a result plaintiff's goods were destroyed by fire. The Court there said, at page 717:

“* * * The liability of the defendant as a bailee for hire was not lessened and the plaintiff was not estopped from asserting such liability merely because the plaintiff may have had knowledge as to the manner in which the defendant conducted its business at the time plaintiff stored his beans with the defendant. (*Stevens v. Stewart-Warner Corp.*, 223 Mass. 44 [111 N.E. 771].)”

4. IN ANY EVENT THE ARGUMENT OF CAPITOL ON THE SUFFICIENCY OF THE EVIDENCE MERELY GOES TO THE WEIGHT OF THE EVIDENCE AND THE NEGLIGENCE OF APPELLANTS IS A QUESTION OF FACT FOR THE DETERMINATION OF THE TRIAL COURT.

Capitol's argument on the sufficiency of the evidence is in essence merely this: That the trial Court should have drawn a different inference from the evidence than it did. It is clear, however, that the evidence is susceptible of the inference of negligence on the part of the warehouseman, and the question of negligence is therefore one of fact for the determination of the trial Court. The case of *Runkle v. So. Pac. Milling Co.*, 184 Cal. 714, mentioned above, is a case strikingly similar to the present one. There the goods of plaintiff were destroyed by fire while stored in defendant's warehouse, and it was contended that the defendant was negligent in not taking proper precautions. The Court there said, at page 717:

“* * * It is idle to discuss upon appeal to this court the weight of the evidence upon which the judgment rests, and, of course, it is only when the facts of a given case are not in any event or in any view of the case susceptible to the inference of negligence sought to be deduced therefrom that the question of negligence becomes one of law for the sole consideration of the court rather than one of fact for the determination of the jury * * *”

After stating that inflammable substances were stored in a wooden structure and pointing out the nature of the fire-fighting equipment the Court in the *Runkle* case stated as follows:

“* * * Whether these fire-fighting appliances were ordinarily adequate and reasonably sufficient as a pro-

tection against loss and damage by fire under all of the circumstances, and considering particularly the situation of the warehouse, was clearly a question of fact for the jury to determine * * *'' (p. 717).

See also *Charles Nelson Co. v. Pacific Wharf & Storage Co.*, 58 Cal. App. 347.

It is submitted that it is not within the province of this Court to weight the evidence and redetermine the question of negligence, which is a question of fact.

5. THERE WAS SUFFICIENT COMPETENT EVIDENCE TO SUPPORT THE AMOUNT OF DAMAGES FIXED BY THE COURT.

Appellant Capitol Chevrolet Company argues in its brief that the Court erred in the admission and exclusion of evidence relating to the number and value of the automobile tires and tubes destroyed by the fire; that there was no support in the evidence for Finding II of the findings of fact as to the quantities of tires and tubes destroyed and the reasonable value thereof; and that this lack of proof regarding value and the uncertainty thereof renders the judgment void.

The Court, in its opinion, fixed the number and value of the tires and tubes destroyed upon the testimony of the witness, Alfred D. McClellan (Tr. p. 74), and the data contained in plaintiff's exhibit No. 3 (Tr. p. 320) and plaintiff's exhibit No. 4. Exhibit No. 3 is a written report from the appellant, Capitol Chevrolet Company, to appellee Defense Supplies Corporation reporting, as agents for Lawrence Warehouse Company, the storer of the tires, the number of tires and tubes destroyed. Capitol now argues that this report made by it is not competent evi-

dence of the facts therein stated. This, we submit, is clearly erroneous.

Capitol claims that the testimony of Mr. McClellan with respect to the number of tires and tubes destroyed and the price paid for such tires and tubes by Defense Supplies Corporation was hearsay, although an examination of the record (Tr. pp. 111 to 131) will show that no objection to this testimony on this ground was interposed at the trial. We submit, therefore, that Capitol's objection, for the first time raised in its brief, comes too late, and that the testimony having been admitted without objection on the ground of hearsay is competent testimony and sufficient to support the judgment.

Diaz v. United States, 223 U. S. 442, 450;

Falk v. Falk, 48 Cal. App. (2d) 762, 789;

1 *Wigmore on Evidence*, Third Edition, 321.

In *Diaz v. United States* (supra), the Court said:

“So, of the fact that it was hearsay, it suffices to observe that when evidence of that character is admitted without objection it is to be considered and given its natural probative effect as if it were in law admissible.” (p. 450.)

Capitol also contends that evidence of the price paid by appellee for the tires and tubes was inadmissible because the price was not a “free market price” but a price fixed by the government as the buyer, and the sale of said tires and tubes to the government at the fixed price was coerced and forced. This is indeed a surprising argument. The true effect of the limitation upon free sale of tires and tubes was to permit the government to purchase at

a price below that which would have existed if there had been a free market, and therefore the appellant was benefited rather than harmed by the use of this arbitrary price in the fixing of value. If it had not been for the government restrictions embodied in the "Idle Tire Program" and the OPA regulations, the value of the tires and tubes destroyed would have been much greater and the damages awarded by the Court would have been proportionately larger.

Capitol also argues that there was uncertainty in the evidence as to the price paid for the tires and tubes because of an alleged discrepancy between the plaintiff's schedule of prices paid and certain OPA price regulations for similar tires. In this connection Capitol, in its brief, refers to the testimony of the witness McClellan appearing at pages 301 to 305 of the transcript. Reference to this testimony will show that the OPA schedules referred to there by Mr. Getz, the attorney for appellant Capitol Chevrolet Company, were never proven to be the schedules of OPA prices in effect at the time the purchases of the tires and tubes were made by the government, and that the prices set forth in plaintiff's exhibit No. 4 (the prices considered by the trial Court in fixing the amount of damages) were without dispute the prices actually paid by appellee for the goods destroyed.

Capitol argues that the value should have been determined by a showing of the reasonable market value immediately prior to the date upon which the "Idle Tire Program" became effective, rather than by the prices actually paid for the goods destroyed. If this procedure

had been followed, it might have resulted in a value actually in excess of the value found by the Court upon the basis of prices paid by the appellee. When the appellee purchased the tires and tubes, the market prices were fixed by OPA schedules then in effect, and these were the prices set forth in appellee's schedule of prices and were the prices paid. We submit that such prices were the best available evidence of value.

The total destruction of the tires and tubes because of the fault of Capitol was the real reason for the uncertainty both as to quantity and value. This uncertainty as to amount is not an obstacle to the allowance of damages. As pointed out by the trial Court in its opinion (Tr. p. 73), "In the case of uncertainty, the most reasonable basis within the boundaries of possibility should be formulated."

Pac. Steam Whaling Co. v. Alaska Packers Association, 138 Cal. 632;

Hanlon D. & S. Co. v. Southern Pac. Co., 92 Cal. App. 230, 235;

Story Parchment Co. v. Paterson, 282 U. S. 555;

Eastman Co. v. So. Photo Co., 273 U. S. 359;

Rilovich v. Raymond, 20 Cal. App. (2d) 630.

An examination of the method of arriving at the value of the goods as set forth by the trial Court in the margin of its opinion will, we believe, show that the trial Court in fact used "the most reasonable basis within the boundaries of possibility". A recitation of the method followed by the trial Court is a sufficient answer to the confused arguments of Capitol. The Court said (Tr. p. 74):

“Graded Tires.

The record (Tr. 22; plaintiff's Exhibit #4, Grade 4) shows that the lowest OPA price for graded tires was \$2.75 per tire. (By plaintiff's unacceptable theory of average cost a value of \$3.48 per tire was claimed. (Tr. 23.) The price of \$2.75 does not in fact represent the lowest price paid by plaintiff for any graded tires, inasmuch as there was deducted from the OPA price on graded used tires 90¢ for each vulcanized spot repair needed and \$1.70 for each reinforcement or sectional repair needed. (Plaintiff's Exhibit #4, Grade 4.) Since it is not unreasonable to assume that tire owners turned in under the 'Idle Tire Purchase Plan' their poorest tires, many of such graded used tires must have been purchased by plaintiff at less than \$2.75, thus serving to offset to some degree other tires purchased for more than \$2.75. These factors would in my opinion reasonably tend to equalize the difference in price to such an extent that a value of \$2.75 per tire may be fixed as a fair and reasonable value of the graded tires destroyed.

Scrap Tires.

No difficulty presents itself as to scrap tires, since plaintiff paid 20¢ each for all tires of this kind.

Graded Tubes.

Likewise appraisement of value here is free of difficulty for the reason that the lowest OPA price for a sound or repaired used tube was \$1.50. (Plaintiff's Exhibit #4, Table VI.) Coincidentally this is average cost per plaintiff's theory.

Scrap Tubes.

There is evidence neither of any OPA price scrap tubes nor of the price paid by plaintiff, but plaintiff

claims a value of 20¢ each. Since graded tubes appear to carry a value of 55% of the value of graded tires, it is fair [and] reasonable to conclude that a similar ratio of value obtained in the case of scrap tires and tubes. Consequently the value of the scrap tubes is fixed at 11¢ each.”

It should be remembered in this case that it was the wrongful act of the appellants which resulted in the destruction of the property of the appellee and of all the evidence from which the actual value of that property could be ascertained. Where this is true, the presumption is that said property is of the highest value that can reasonably be estimated.

Armory v. Delamirie, 1 Strange 504, 1 Smith's Leading Cases 679;

Fox v. Hale & Norcross S. M. Co., 108 Cal. 369, 415;

2 *Sutherland* (4th ed.) 1414-15;

4 *Sutherland* (4th ed.) 4224-25.

Where there is no doubt that the plaintiff has suffered damage and the only question is the amount of damage suffered, the Court should apply a liberal rule in calculating the amount and plaintiff's recovery is not limited to so much of the damage as can be calculated with certainty.

25 *C. J. S.* 494-6, 815;

Hanlon D. & S. Co. v. Southern Pac. Co., 92 C. A. 230, 235;

Pye v. Eagle Lake Lumber Co., 66 C. A. 584;

Larson v. Union Investment & Loan Co., 10 P. (2d) 557 (Wash.);

78 *A. L. R.* 858, note.

This is particularly true where the wrong itself renders proof of the amount of damage difficult. In such a case, the defendant cannot escape making proper amends where he is responsible for the difficulty.

Seymour v. Oelrichs, 156 Cal. 782, 803;

Hacker, etc. Co. v. Chapman V. Mfg. Co., 17 C. A. (2d) 265, 272;

California Orange Co. v. Riverside P. C. Co., 50 C. A. 522;

Story Parchment Co. v. Paterson Co., 282 U. S. 555, 75 L. ed. 544;

Sauntry v. U. S., 117 Fed. 132 (C. C. A. 8).

This rule applies to a case where the property sought to be valued is of various grades and plaintiff is unable to show with certainty the amount of each grade.

Pye v. Eagle Lake Lumber Co., supra, at page 591.

In view of the above rules, we submit that the Court did not err in either the admissibility of testimony with respect to damages nor in fixing the amount thereof upon the basis of the testimony that was admitted. On the contrary, it may well be argued under the state of the law as recited above, that the Court should, in this case, have taken not the lowest price for graded tires, but an average price or the highest price.

ARGUMENT ON CASE AGAINST LAWRENCE WAREHOUSE
COMPANY.

1. THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE FIND-
ING OF NEGLIGENCE ON THE PART OF LAWRENCE.

As heretofore shown, appellant Capitol Chevrolet Company was acting as agent of appellant Lawrence Warehouse Company for the storage of the tires and tubes of appellee. Lawrence as principal is therefore liable to appellee for the negligence of its agent in the transaction of the business of the agency.

Cal. Civil Code, Sec. 2338.

Our remarks concerning the liability of Capitol are pertinent here for if Capitol is liable to appellee then Lawrence can not escape. In order to avoid repetition we refer the Court to our argument on the case against Capitol set forth above.

The liability of Lawrence to appellee is also predicated on the contractual relationship between Lawrence and appellee. The contract of storage contained the following provision: "Your (Lawrence's) general responsibility for the care and protection of the tires will be limited to such care as is required by laws governing warehouses in your state and to the exercise of ordinary care on your part." (Tr. p. 314.)

A warehouseman is liable for the loss of the property of the bailor by fire unless the warehouseman exercises reasonable care and diligence for the protection and preservation of the property.

Cal. Civil Code, Sec. 1858e;

*California Warehouse Receipts Act, Sec. 21, Deer-
ing's General Laws, Act 9059.*

In the present case Lawrence, through its agent Capitol Chevrolet Company, permitted the use of an acetylene torch on the warehouse premises contrary to express instructions of appellee and in spite of the fact highly inflammable goods were stored therein. What precautions, if any, were taken against the fire by Lawrence has not been shown. Lawrence and its agent were clearly negligent and responsible for the loss of appellee's tires and tubes.

Lawrence, in its brief under the heading "The Liability of Lawrence", makes certain statements of fact which it claims are admitted facts, without reference to the record. In order to avoid any misunderstanding, we wish to point out that certain of the purported facts there stated are stated in such a way as to be misleading, and as so stated are not supported by the evidence and have not been admitted by appellee. For instance, on page 7 of its brief, Lawrence states that it had no active part in the conduct of the warehouse and was not represented at the warehouse by any employee except the watchmen. The evidence does not disclose whether or not any employees or officers of Lawrence took any active part in the operation of the warehouse. This, however, is immaterial in view of the fact that the warehouse was under the control of the agent of Lawrence. If in fact Lawrence never inspected the operations of the warehouse, this would be a factor indicating negligence on its part but could not relieve it of liability for the negligence of its agent.

Lawrence further states, on page 7 of its brief, that Capitol received instructions directly from appellee. This is directly contrary to the evidence which shows that

written instructions regarding storage of the goods were delivered to Lawrence at the time of the execution of the storage agreement. (Tr. p. 105.) There was evidence that appellee gave Capitol written instructions regarding the admission of persons to the premises (Tr. pp. 191-192), but similar instructions were given at the same time to Lawrence. (Tr. pp. 205-206.)

Lawrence next states in its brief that the list of persons who could be admitted to the premises did not include any of its officers or employees. The list, however, did include officers and employees of its agent Capitol Chevrolet Company, and there is no evidence that the list was intended to exclude representatives of Lawrence.

It is also stated by Lawrence that the choice of the Burns Detective Agency was made by appellee. This is directly contrary to the fact. Lawrence's own counsel stated at the trial that appellee requested guard service but did *not* prescribe any particular guard. (Tr. p. 286.) In this connection, it may be remarked that the argument that because Lawrence, as principal, supplied its agent with watchmen it is therefore relieved from liability for the acts of its agent, is indeed a novel one and as far as we know is supported by no authorities.

The argument of Lawrence on the question of the sufficiency of the evidence, although not entirely clear, appears to be based on the proposition that there are no proven facts from which an inference of negligence can be drawn. We believe we have heretofore adequately shown in our argument on the case against Capitol that there is substantial evidence of negligence. Tires and tubes were stored in a frame building and a workman was

permitted to enter to use an acetylene torch. The only fire-fighting equipment available and used was a 5-gallon bucket of water. (Tr. p. 219.) There was no evidence of any other precautionary measures taken by the warehouseman. We refer again to the case of *Runkel v. Southern Pacific Milling Co.*, 184 Cal. 714, which involved very similar circumstances and where the Court held that the verdict of the jury against the warehouseman must be upheld. We also refer again to that case in answer to the contention of Lawrence that appellee's knowledge of the operation of the warehouse should relieve Lawrence of liability. (See brief of Lawrence, pp. 11-12.) As heretofore pointed out, the Court in the *Runkle* case held that such knowledge does not absolve the warehouseman.

2. THERE IS SUBSTANTIAL EVIDENCE TO SUPPORT THE FINDING THAT THE DAMAGE WAS PROXIMATELY CAUSED BY THE NEGLIGENCE OF LAWRENCE.

The argument of Lawrence in this connection is based on the contention that the act of McGrew in using the torch was an intervening cause which broke the chain of causation and that, therefore, Lawrence can not be liable. In support of this contention, Lawrence relies on a decision of the Supreme Court of Arizona. (*Salt River Valley Water Users Association v. Cornum*, 63 Pac. (2d) 639.) It is submitted that the law on this subject is so well settled in California that there can be no doubt as to how it stands. There are numerous decisions of our Supreme Court and District Courts of Appeal to the effect that two or more defendants may be liable for an injury caused by their separate negligent acts, where the negligence of each was a proximate cause of the injury. (See 19 *Cal. Juris.* 572 and cases there cited.)

A few of the more recent decisions of our Supreme Court may be referred to.

In *Taylor v. Oakland Scavenger Co.*, 17 Cal. (2d) 594, the Court was concerned with the following situation:

The plaintiff, a school girl, was struck by a truck while she was crossing a street adjacent to the school grounds. Plaintiff sued the truck driver and owner and the School District, contending that the truck was negligently operated and that the employees of the School District were also negligent in not taking proper precautions for the safety of the child. The jury awarded damages against all defendants and this was affirmed by the Supreme Court. In the course of its opinion, the Court said (p. 602):

“The school district maintains, however, that any breach of duty on the part of its employees was not a proximate cause of the injury to plaintiff because the negligence of the truck driver was an efficient intervening cause. Conversely, the Santuccis and the Scavenger Company contend that any breach of duty on the part of the truck driver was not a proximate cause of the injury because the negligence of the school authorities was an efficient intervening cause. If an injury is produced by the concurrent effect of two separate wrongful acts, each is a proximate cause of the injury, and neither can operate as an efficient intervening cause with regard to the other. (Citing cases.) The fact that neither party could reasonably anticipate the occurrence of the other concurrent cause will not shield him from liability so long as his own negligence was one of the causes of the injury. (Citing cases.) The arguments of defendants themselves make clear that more than one

conclusion may reasonably be drawn from the conflicting evidence of this case, and the determination of the jury that the negligence of each defendant contributed concurrently to the plaintiff's injury cannot therefore be disturbed on appeal."

In the present case the trial Court has found that both the negligence of the warehouseman in not taking proper precautions and the negligence of McGrew in using the torch contributed to the loss, and that each was a proximate cause of the loss. (Tr. pp. 78 to 81.) These findings are supported by the evidence and must stand. Since both the warehouseman and McGrew contributed to the loss, both are liable. See also the following recent decisions which are in accord with the *Taylor* case:

Mosley v. Arden Farms, 26 Cal. (2d) 213;

Westover v. City of Los Angeles, 20 Cal. (2d) 635.

ARGUMENT ON CASE AGAINST V. J. MCGREW.

1. THIS COURT HAS NO JURISDICTION OVER THE APPEAL OF MCGREW.

Appellant V. J. McGrew's appeal from the judgment against him was filed too late and this Court, therefore, has no power to hear the appeal. The judgment against McGrew was entered on April 15, 1946 (Tr. pp. 83 to 85) and he filed his notice of appeal on July 16, 1946. (Tr. p. 96.)

An appeal must be filed within three months of entry of the judgment and failure to do so is jurisdictional and

deprives the Circuit Court of Appeals of power to hear the appeal.

28 *U. S. C. A.*, Sec. 230;

10 *Cyc. of Federal Procedure*, Sec. 5176.

Here McGrew has filed his appeal one day late.

In a case where the judgment was entered on March 17, 1934, and the appeal was filed on June 18, 1934, the Court dismissed the appeal because the three-month period had elapsed.

Walters v. Balt. & Ohio Railroad Co., 76 Fed. (2d) 599.

2. THERE IS SUBSTANTIAL EVIDENCE THAT MCGREW CAUSED THE FIRE BY THE NEGLIGENT USE OF THE ACETYLENE TORCH.

Even though we believe that this Court can not hear the appeal of McGrew, we will remark briefly on the issue raised by this appellant as it may aid the Court in its determination of the case as a whole. McGrew in his brief speaks of the insufficiency of the evidence in general, but it will be noted that he relies principally on the contention that the evidence is insufficient to support a finding that the torch caused the fire.

The only eye witness to the start of the fire was McGrew, a witness adverse to appellee. McGrew humanly enough did not admit on the stand that his torch set the fire. Nevertheless, his testimony can give rise to no other conclusion.

McGrew was alone in the engine room when the fire started and he first observed the fire shortly after he had

been using the torch. (Tr. pp. 220-221.) He testified that when he first saw the fire it was between the brine tank which he had been cutting and the south wall of the building, a distance of less than six feet from the place where he had last used the torch. (Tr. pp. 221-222.) He could offer no other explanation for the fire and no evidence of any other possible cause was produced. It should also be noted that the guard Kissell saw McGrew shortly after he had reported the fire and testified to a conversation with McGrew in which the latter admitted that the fire started where he had been cutting the tank with the torch. Kissell testified as follows (Tr. p. 284):

“A. I don’t remember just exactly the words he used, but he said he hated to see the place burn down, it was quite a mess.

Q. Did he say anything else?

A. So I said, ‘It sure is.’ Then he told me that he was the man that was working there, and I said ‘Were you?’ and he said, ‘Yes.’ And I said, ‘I wonder how that thing got started.’ And he said, ‘Well, it looks to me like it started there, right where I was cutting or close to where I was cutting with the torch,’ as near as he could tell.”

In addition, we wish to point to the following testimony:

1. That there was something on the floor underneath the tank but McGrew “didn’t check into the thing.” (Tr. p. 224.)

2. That McGrew did not know whether or not the tank was set on cork covered with asphalt and tar. (Tr. p. 232.)

3. That while the men were using the torch prior to the fire, the guard Kissell saw some "dark material" just under the edge of the tank. (Tr. p. 281.)

We do not think that it is too much to contend that McGrew should have inspected the area underneath the tank or that it is unreasonable to state that merely throwing two buckets of water under the tank some ten minutes prior to observing the fire is not a sufficient precautionary measure.

The use of an acetylene torch close to inflammable materials is evidence of negligence, and in the absense of a showing by the defendant that reasonable precautions were taken to prevent the outbreak of fire, judgment must be given for the plaintiff.

Reliance Insurance Co. v. Pohlking, 19 N.E. (2d) 906 (Ohio).

When the thing which causes the damage is under the management and control of the defendant and the accident is such as in the ordinary course of events does not happen if proper precautions are taken, it affords reasonable evidence, in the absence of explanation by the defendant, that the accident arose from want of care.

Gerhart v. Southern Cal. Gas Co., 56 Cal. App. (2d) 425;

White v. Spreckels, 10 Cal. App. 287, 101 Pac. 920;

Judson v. Giant Powder Co., 107 Cal. 549, 40 Pac. 1020;

19 Cal. Jur. 704, et seq.

McGrew argues that the doctrine of *res ipsa loquitur* does not apply because there has been no showing that the acetylene torch caused the fire. As pointed out above,

there can be no doubt of the fact that the fire was set by the torch. We do not believe that appellee has the burden of eliminating all other possible causes.

McGrew cites the case of *Bartholomai v. Owl Drug Co.*, 42 Cal. App. (2d) 38 as being controlling here. In this connection the trial Court in its opinion stated as follows (Tr. pp. 65-66):

“I do not feel bound to follow the cited case of *Bartholomai v. Owl Drug Co.*, 42 Cal. App. (2d) 38, inasmuch as it fails to recognize the existence of a duty upon the part of a person using an instrumentality capable of igniting combustible material to ascertain the presence of such material nearby and to safeguard against its ignition. The case of *Wilson v. Southern Pacific R. R. Co.*, 62 Cal. 164, appears to me to be in point and persuasive against defendant's contention.”

We believe the opinion of the trial Court is sound. Furthermore, the *Bartholomai* case differs from the present one in several material respects:

1. In the *Bartholomai* case the workman was standing on a platform some distance above a temporary floor and the fire started beneath the floor.

2. In the *Bartholomai* case there were other persons present near the place where the fire started.

3. The Court in the *Bartholomai* case affirmed the judgment of the trial Court. Thus, even though the facts were sufficient to raise an inference of negligence, the Appellate Court could not reverse the lower Court inasmuch as the evidence was also susceptible of the inference that the defendant was not negligent.

CONCLUSION.

In conclusion, it is submitted that there is ample evidence to support the findings of the trial Court that the loss of appellee's tires and tubes was caused by the negligence of appellants, and the judgment of the trial Court against the appellants should therefore be affirmed.

Dated, San Francisco, California,

August 12, 1947.

Respectfully submitted,

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Attorneys for Appellee,

Defense Supplies Corporation.

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

LAWRENCE WAREHOUSE COMPANY
(a corporation), *Appellant,*

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

CAPITOL CHEVROLET COMPANY
(a corporation), *Appellant,*

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

V. J. MCGREW,
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

DEFENSE SUPPLIES CORPORATION,
Appellant,

vs.

CLYDE W. HENRY,
Appellee.

BRIEF OF APPELLANT LAWRENCE WAREHOUSE COMPANY

IN REPLY TO

BRIEF OF DEFENSE SUPPLIES CORPORATION.

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Subject Index

	Page
Statement of the case	2
A. The facts	2
B. The issues	6
That certain of the findings of fact are conflicting and are opposed to each other and therefore cannot sup- port the conclusions of law or the judgment.....	6
There was no evidence of actual negligence on the part of Lawrence Warehouse Company	7
Lawrence Warehouse Company is not liable as principal for an act of its agent outside the scope of the agent's authority	7
Argument	8
Could the alleged negligence of Lawrence Warehouse Com- pany have been a proximate cause of the damage	14
Conclusion	17

Table of Authorities Cited

Cases	Page
Mosley v. Arden Farms, 26 Cal. (2d) 213	16
Runkle v. Southern Pacific Milling Co., 184 Cal. 714	15
Silverado Steamship Co. v. Prendergast, 31 Fed. (2d) 225	11
Taylor v. Oakland Scavenger Co., 17 Cal. (2d) 594,....	15
Westover v. City of Los Angeles, 20 Cal. (2d) 635	16

Codes

California Civil Code:

Section 2338	7
Section 2339	11

Texts

3 Corpus Juris Secundum, p. 190	11
---------------------------------------	----

No. 11,418

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CLYDE W. HENRY,
Appellee.

BRIEF OF APPELLANT LAWRENCE WAREHOUSE COMPANY
IN REPLY TO
BRIEF OF DEFENSE SUPPLIES CORPORATION.

STATEMENT OF THE CASE.**A. THE FACTS.**

In its Statement of the Facts, Appellee, Defense Supplies Corporation, has inadvertently confused the chronology of events. The so-called "Idle Tire Purchase Plan" for the collection of surplus rubber tires was initiated by the Government in the early months of 1942. The original agreement between the Government and the Lawrence Warehouse Company was dated prior to October 1, 1942, and the agreement between Lawrence Warehouse Company and Capitol Chevrolet Company (Plaintiff's Exhibit 11, Tr. 341) was dated October 1, 1942. This agreement between the Lawrence Warehouse Company and the Capitol Chevrolet Company was in "the form of all agency agreements which Defense Supplies Corporation provided to the Lawrence Warehouse Company for use in dealing with its agents." (Tr. p. 110.) The actual receipt of tires commenced on October 15, 1942. (Tr. p. 139.)

On January 22, 1943, the Defense Supplies Corporation wrote a letter of instructions to the Capitol Chevrolet Company, in which the Government agency instructed the Capitol Chevrolet Company as follows:

"You are requested not to permit any one to enter the warehouse premises where tires are stored for account of this corporation for any reason whatsoever, other than authorized appraisers or properly identified employees of this Corporation."

At the time of this letter the Capitol Chevrolet Company was operating eleven warehouses in Sacramento in every conceivable kind of vacant space.

The Defense Supplies Corporation decided to consolidate the storage of tires in one building. A large wooden building located in West Sacramento was available for that purpose.

“Said warehouse known as the ‘Ice Palace’ was leased by defendant Capitol Chevrolet Company from Clyde W. Henry and Constantine Parella for use as a warehouse for the storage of tires, after inspection of said ‘Ice Palace’ by plaintiff prior to said lease and with the consent, approval and authorization of plaintiff for the leasing of said premises and their use for the storage of tires and tubes.”

(Finding of Fact IV-A, Tr. p. 80.)

The lease between Capitol Chevrolet Company and Appellant Henry and Constantine Parella was dated March 1, 1943 and contained, among others, the following provisions:

“that no alterations, repair or change whatever shall be made in or about said leased premises without the written consent of the Lessor.”

(Plaintiff's Exhibit 6, Tr. p. 328.)

Said Lessor had the right

“at all times during the term of this lease to enter said leased premises for the purpose of examining or inspecting the same and of making such repairs or alterations therein or in other parts of said building as said Lessor shall deem

necessary in connection with said premises or said building.” (Plaintiff’s Exhibit 6, Tr. p. 331.)

On the same date, March 1, 1943, the Defense Supplies Corporation addressed a letter to the Lawrence Warehouse Company approving storage in the so-called “Ice Palace.” (Plaintiff’s Exhibit 7, Tr. p. 310.)

Thereafter the Defense Supplies Corporation prepared a list of “Men Eligible to Enter DSC Warehouse”. That list included the President of Capitol Chevrolet Company, the warehouse foreman employed by Capitol Chevrolet Company, the chief tire appraiser employed by Defense Supplies Corporation, the real estate operator who had negotiated the lease between Capitol Chevrolet Company and the owners; the owners of the property, the Supervisor of Capitol Chevrolet Company; and 9 individual tire pilers and stackers, all employed by Capitol Chevrolet Company. No officer or employee of the Lawrence Warehouse Company was named on that list. No officer or employee of Lawrence Warehouse Company was named in the previous letter of instructions of January 22, 1943, from Defense Supplies Corporation to Capitol Chevrolet Company. (Plaintiff’s Exhibit 9.) On January 22, 1943, the Defense Supplies Corporation directed a letter to Lawrence Warehouse Company in which they advised the Lawrence Warehouse Company that Mr. Kenyon of the Capitol Chevrolet Company had been instructed to permit no one to enter the warehouse premises where tires were

stored for the account of the corporation other than authorized appraisers or properly identified employees of the Defense Supplies Corporation.

The Defense Supplies Corporation desired that the premises and the tires stored therein be guarded twenty-four hours a day and approved of the Burns Detective Agency as an independent agency to furnish such guards. The Lawrence Warehouse Company employed the Burns Detective Agency and paid for the watchmen, and the Defense Supplies Corporation reimbursed the Lawrence Warehouse Company. (Tr. pp. 284-5-6.)

In its statement of the facts (Brief for Appellee, p. 3), the Defense Supplies Corporation states that while the Appellant McGrew was using an acetylene torch in cutting up a steel tank in the engine room adjoining the warehouse premises, a fire started in the engine room and spread to the main building where the tires and tubes were stored. The only testimony upon the question is that of McGrew and his testimony is that he neither saw nor smelled any evidence of fire at the time he was using the torch and that, when he first observed the fire, it was some eighteen feet from the spot where he had previously used the torch (Tr. pp. 240-241), and was in the southeast corner of the engine room. (T. p. 248.) He had no idea of the source of the fire. (Tr. p. 249.)

The other witness, who saw the fire in its early stage, was Mr. Kissell, the Burns watchman. He first saw it about ten feet east of the concrete fire wall on

the south end of the storage building, that is to say, about ten feet east of the engine room and in the storage building. (Tr. p. 298.)

The trial Court evidently did not believe the testimony of McGrew or Kissell, notwithstanding that Kissell was the plaintiff's witness and the fact that it was the only testimony in the record relating to the place at which the fire started. The trial Court assumed that McGrew's use of the torch caused the fire and then upon this assumption premised that the use of the torch was negligent.

B. THE ISSUES.

THAT CERTAIN OF THE FINDINGS OF FACT ARE CONFLICTING AND ARE OPPOSED TO EACH OTHER AND THEREFORE CANNOT SUPPORT THE CONCLUSIONS OF LAW OR THE JUDGMENT.

In its statement of the issues raised by Appellant, Lawrence Warehouse Company (Brief, p. 5), Appellee, Defense Supplies Corporation, fails to mention the contention that certain of the findings of fact are conflicting and opposed to each other and, therefore, cannot support the conclusions of law based thereon or the judgment. This issue, argued in Appellant's Opening Brief at pages 14, 15 and 16, is also ignored in the argument presented by Appellee, Defense Supplies Corporation. We believe the argument to be sound and that it disposes of Appellee's case, but, in view of the fact that it is not disputed, we will pass the point without further comment.

**THERE IS NO EVIDENCE OF ACTUAL NEGLIGENCE ON THE
PART OF LAWRENCE WAREHOUSE COMPANY.**

In its brief, Appellee does not argue that there was any substantial evidence of actual negligence on the part of Lawrence Warehouse Company.

**LAWRENCE WAREHOUSE COMPANY IS NOT LIABLE AS PRIN-
CIPAL FOR AN ACT OF ITS AGENT OUTSIDE THE SCOPE
OF THE AGENT'S AUTHORITY.**

As an attempted answer to that portion of the brief of Lawrence Warehouse Company in which it was argued that there was no substantial evidence of such negligence, the Appellee, Defense Supplies Corporation, now argues that:

(a) Capitol Chevrolet Company was negligent in permitting the entry of McGrew;

(b) Capitol Chevrolet was an agent of Lawrence Warehouse Company for the storage of tires;

(c) Lawrence Warehouse Company was therefore liable as principal for the negligence of its agent Capitol Chevrolet.

In support of this theory, the Defense Supplies Corporation relies upon California Civil Code, section 2338, which provides:

“A principal is responsible to third persons for the negligence of his agent in the transaction of the business of the agency, including wrongful acts committed by such agent in and as part of the transaction of such business, and for his willful omission to fulfill the obligations of the principal.”

ARGUMENT.

There are several answers to the argument so advanced by Defense Supplies Corporation:

First: It is not supported by the Findings of Fact. There is no finding that the acts of Capitol Chevrolet Company, which are alleged to have constituted negligence, were performed by that company as an agent of Lawrence Warehouse Company or that the acts were within the scope of the agency.

In Finding III (Tr. p. 79), the Court finds that the Defendant McGrew negligently operated an acetylene torch and set fire to the premises.

Finding IV sets forth that McGrew was given permission by the Defendant Henry to enter the premises and remove the tank.

In Finding V, the Court found that Defendants Lawrence Warehouse Company and Capitol Chevrolet Company failed and omitted to exercise reasonable care and that said defendants negligently permitted the use of the torch on the premises and negligently failed to see that the torch was used in the proper manner. The finding concludes that, by reason of such negligence and carelessness, the premises and the plaintiff's goods were consumed and destroyed by fire.

In Finding VI, the Court found that the negligence of McGrew, Lawrence and Capitol Chevrolet concurred and joined together to destroy the plaintiff's goods.

It will be immediately noted that there is no finding that Lawrence Warehouse Company is charged as principal for the acts of its agent. It is elementary that if the principal is to be charged with the acts of its agent, the Court must first find that the acts of the agent were within the scope of the agent's authority. No such finding was made by the Court in the present case.

Second: The Court could make no finding that the Capitol Chevrolet in permitting McGrew to enter the engine room was acting within the scope of the agent's authority for the reason that the act of Capitol Chevrolet in permitting McGrew to enter the engine room on behalf of the owner to remove the tank owned by the owner was an act performed by Capitol Chevrolet Company in its relationship of tenant and not an act performed in the scope of its authority as custodian of the stored tires. Heretofore we have set forth the pertinent provisions of the lease between Capitol Chevrolet Company and the owner of the premises. The evidence is clear the Capitol Chevrolet Company permitted McGrew to enter the engine room only after obtaining approval of Mr. Turner, the real estate agent representing the owners, and also one of the persons who was on the list of persons authorized by the Defense Supplies Corporation to enter the premises. His purpose in entering the premises had nothing whatever to do with the adjoining building in which tires were stored. It was solely for the purpose of removing a tank belonging to the owner of the premises. In making

this statement, we have taken the evidence most favorable to Defense Supplies Corporation. It was the contention of the Capitol Chevrolet Company that they neither permitted nor knew of the intent or purpose to use an acetylene torch. The Capitol Chevrolet contended that the only authorization given by them was an authorization to permit Mr. Tony Sanchez and two of his men to enter and remove pipe and equipment (Tr. p. 339), and it is clear from the testimony of Mr. Henry that the pipe and equipment referred to on the card were removed several days before the fire. (Tr. p. 178.) The Defense Supplies Corporation authorized the Capitol Chevrolet Company to enter into the lease with Henry and Parella. In accordance with the terms of the lease Defense Supplies Corporation authorized Capitol Chevrolet Company to permit Henry, Parella and their real estate agent to enter the premises. (Plaintiff's Exhibit 10, Tr. p. 340.) The Defense Supplies Corporation contends that McGrew entered the premises with the approval of the Capitol Chevrolet Company. If so, that approval was given under the terms of the lease and after authorization by the agent of the owners. That authority was not given as agent of Lawrence Warehouse Company nor did the act of entering or removing the tank have anything whatsoever to do with the authority of Capitol Chevrolet Company as a custodian of the goods. The act of requesting authority of the owner indicates perfectly clearly that Capitol Chevrolet was acting pursuant to the terms of the lease and not pursuant to any agency agreement with Lawrence Warehouse Company.

There is a discussion of the authorities in the case of *Silverado Steamship Company v. Prendergast*, 31 Fed. (2d) 225, 226, by the Circuit Court of Appeals of this Circuit in which the Court states the rule as follows:

“Generally a principal is liable for his agent’s torts only if they are committed while the agent is carrying on his principal’s business. If the agent steps aside from that business to promote purposes of his own having no connection with his employer’s business, the relation of agency is for the time being and to that extent suspended.”

Appellee attempts to answer this recognized rule by stating that the admitted lack of knowledge by Lawrence Warehouse Company of the entry of McGrew could not relieve it of liability for the alleged negligence of its agent. (Appellee’s Brief, p. 27.) It is, of course, apparent that there were no circumstances sufficient to put Lawrence on inquiry.

“In the absence of circumstances sufficient to put the principal on inquiry, the principal is not responsible for the torts of his agent which were committed outside of the course of the agent’s authority, on the grounds that the principal by the exercise of diligence could have discovered the agent’s misconduct in time to avoid injury to a third person.”

3 C. J. S., p. 190;

California Civil Code, section 2339.

Third: The Appellee, Defense Supplies Corporation, by its own acts defined specifically the duties of the Lawrence Warehouse Company in connection with this particular warehouse.

(1) Defense Supplies Corporation inspected and approved the premises for the storage of tires;

(2) Defense Supplies Corporation authorized Capitol Chevrolet Company to lease the premises;

(3) Defense Supplies Corporation specifically designated by name the persons who could enter the premises, excluding any officer or employee of Lawrence Warehouse Company. It instructed Lawrence Warehouse Company to employ an independent agency to supply watchmen (and approved the particular watchmen employed and paid for those watchmen) as the only act to be performed by Lawrence Warehouse Company on the premises.

In its brief, at pages 27 and 28, Defense Supplies Corporation argues as follows:

“Lawrence further states, on page 7 of its brief, that Capitol received instructions directly from appellee. This is directly contrary to the evidence which shows that written instructions regarding storage of the goods were delivered to Lawrence at the time of the execution of the storage agreement. (Tr. p. 105). There was evidence that appellee gave Capitol written instructions regarding the admission of persons to the premises (Tr. pp. 191-192), but similar instructions were given at the same time to Lawrence. (Tr. pp. 205-206.)”

Our statement that Capitol received its instructions directly from Defense Supplies Corporation is not directly contrary to the evidence. Plaintiff's Exhibit 9 was admittedly received directly from the Defense Supplies Corporation. Plaintiff's Exhibit 13, which

was a letter written by Defense Supplies Corporation to Lawrence Warehouse Company on the same day, advised Lawrence that specific and direct instructions had been given to Mr. Gordon Kenyon of Capitol Chevrolet Company. The instructions contained in Plaintiff's Exhibit 9 could not be more specific.

“You are requested not to permit *any one* to enter the warehouse premises * * * for any reason whatsoever other than authorized appraisers or properly identified employees of this Corporation.”

What better words of exclusion could be used, we cannot conceive. These instructions were given prior to the lease by Capitol Chevrolet of the Ice Palace. When the Defense Supplies Corporation approved the leasing of the Ice Palace by Capitol Chevrolet, it made assurance doubly sure by handing to Capitol Chevrolet a list of specifically named persons authorized by Defense Supplies Corporation to enter the premises. (Plaintiff's Exhibit 10, Tr. p. 340.)

Thus Defense Supplies Corporation did deal directly with the actual custodian and did give the actual custodian specific instructions. It also gave Lawrence Warehouse Company specific instructions and those instructions were to hire independent watchmen. It approved of the Burns Detective Agency as an independent agency to furnish watchmen and those watchmen were hired by Lawrence and Lawrence was reimbursed by Defense Supplies Corporation for their employment. By authorizing

the leasehold and by authorizing Capitol Chevrolet directly to permit the owners of the premises to enter under the terms of the lease, Defense Supplies Corporation, not Lawrence, authorized the agent of Lawrence to perform an act outside of the scope of the agency with Lawrence.

COULD THE ALLEGED NEGLIGENCE OF LAWRENCE WAREHOUSE COMPANY HAVE BEEN A PROXIMATE CAUSE OF THE DAMAGE?

While Appellee purports to answer the contention of this Appellant that the negligence of Lawrence as found by the trial Court was passive and could not therefore be concurrent with an active negligence to support the judgment (Appellant's Op. Brief, pp. 13-14; Appellee's Brief, pp. 29-30), it cannot escape its own admission that "Here the loss was caused by the use of an acetylene torch on the premises." (Appellee's Brief, pp. 9, 17.) It relies on this "cause" to avoid its further admission that Appellants would be relieved of liability for loss resulting from a "known defect in the premises", (Id. p. 9), or "where a bailor has knowledge of conditions under which the goods are stored." (Id. p. 17.) It will be recalled by the Court that counsel for Appellee stated, and the Court found (Tr. pp. 110-111; Finding of Fact IV-A, p. 80), that an employee of Appellee inspected the premises and had authorized their use under lease. The contract (Plaintiff's Exhibit 1, Tr. p. 310) between Lawrence and Appellee

provided for storage in the Ice Palace. It would be futile for Appellee to argue that it was not charged with knowledge of the conditions of the Ice Palace.

Defense Supplies Corporation also instructed exactly who was to be upon the premises and no one was permitted on the premises except the persons named by Defense Supplies Corporation in Plaintiff's Exhibit 10 and the approved watchman. Those persons were at lunch when the fire started except only the Burns watchman. If there were insufficient persons to attempt to control the fire, the fault was the fault of the Defense Supplies Corporation and not of Lawrence Warehouse Company.

The finding that Lawrence and Capitol Chevrolet omitted to provide adequate protection for the premises or to use reasonable care for the protection and preservation of the goods is clearly error. The Warehouse Company and the Capitol Chevrolet did what they were instructed to do by Defense Supplies Corporation.

The Appellee relies upon the case of *Runkle v. Southern Pacific Milling Co.*, 184 Cal. 714. As the Court states at page 719, that case turned upon the liability of the defendant for employing an "employee whom it knew was not competent * * * to be placed in charge of his warehouse and the property of the plaintiff therein". There is no such issue in the present case.

In *Taylor v. Oakland Scavenger Co.*, the Court held that the school authorities had a duty to super-

wise the children and to actively enforce the rules and regulations. The child was injured at a time when she was following the specific instructions given to her by the teacher. The injury, therefore, resulted from two active acts of negligence.

In the *Westover* case, the negligence for which the city was charged was permitting a defect in the street—one which could be reasonably anticipated to cause the type of injury suffered in that case.

In the *Mosley* case, also cited by Defense Supplies Corporation in its brief, the Court held that the defendant could reasonably have foreseen the risk inherent in wrongfully stacking the milk crates alongside a playground.

In the case at bar, the Lawrence Warehouse Company could not possibly have foreseen that the Capitol Chevrolet would permit McGrew to enter the premises with a blow torch, or that, if so permitted, McGrew would negligently use the torch.

At page 28 of its brief, Appellee suggests that this Appellant argues that, because it supplied watchmen, “it is therefore relieved from liability for the acts of its agent”. We are unable to find any such argument in the brief submitted by this Appellant. The argument of Appellant in this connection is set forth on page 9 of its brief.

CONCLUSION.

We therefore respectfully submit that there is no evidence in the record to support a finding that the Lawrence Warehouse Company was negligent; that the brief filed on behalf of Appellee proceeds not upon the assumption that Lawrence was itself negligent but upon the proposition that an agent of Lawrence Warehouse Company was negligent, and that Lawrence Warehouse Company was responsible for the act of its agent; that there is no evidence in the record to support a finding that Capitol Chevrolet was negligent; and that there was no finding of fact or evidence to support a finding of fact that if Capitol Chevrolet was negligent, its negligence consisted of an act within the scope of its agency. That the finding of fact that the loss was caused by the affirmative act of McGrew is directly opposed to and contrary to the finding of fact that the loss resulted from concurrent negligence of McGrew, Lawrence and Capitol Chevrolet and is also contrary to the finding that the loss resulted from the negligence of Capitol Chevrolet and Lawrence Warehouse Company. That the negligence of Lawrence Warehouse Company, as found by the Court, and the negligence of McGrew, as found by the Court, cannot as a matter of law or of fact support a finding that the concurrent negligence of both resulted in the loss, for the reason that the affirmative, positive act of McGrew was found to be the proximate cause of the damage and that a proximate, affirmative act cannot as a matter of law concur with a mere passive failure to act.

It is also submitted that the evidence in this case is directly contrary to the Court's findings of fact with respect to the negligence of this Appellant and that the conclusions of law are not supported by the findings of fact and are contrary to said findings and that the judgment of the trial Court should be reversed.

Dated, San Francisco,
September 29, 1947.

Respectfully submitted,

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Lawrence Warehouse

Company.

No. 11,418.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LAWRENCE WAREHOUSE COMPANY (a corporation),
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

CAPITOL CHEVROLET COMPANY (a corporation),
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

V. J. McGREW,
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

DEFENSE SUPPLIES CORPORATION,
Appellant,

vs.

CLYDE W. HENRY,
Appellee.

REPLY BRIEF OF APPELLANT, CAPITOL
CHEVROLET COMPANY.

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TABLE OF AUTHORITIES CITED

CASES	PAGE
Bartholomai v. Owl Drug Co., 42 Cal. App. (2d) 38.....	10, 13, 16
Briggs v. Oliver, 4 Hurl. & Colt. 403.....	15
Brill v. Miller, 140 App. Div. Rep. (N. Y.) 602.....	2
Brooks v. Somerville, 106 Mass. 271.....	14
Cornman v. E. C. R. Co., 4 H. & N. 781, L R., 3 App. Cas. 1155, 99 Mass. 612.....	15
Cotton v. Wood, 8 C. B. (N. S.) 568.....	14
Denny v. Williams, 5 Allen 1.....	14
Erie v. Tompkins, 304 U. S. 64.....	7, 8
Illinois Central R. R. Co. v. Benton, 69 Ill. 174.....	14
International S. S. Co. v. Fletcher Co., 296 Fed. 855.....	5
Lancashire Shipping Co. v. Morse Dry Dock & Repair Co., 43 F. (2d) 750.....	6
McCaig v. Erie R. R. Co., 8 Hun. 599, 104 Mass. 71.....	15
Reliance Insurance Co. v. Pohlking, 19 N. E. 906.....	5
Roberts v. Gurney, 120 Mass. 33, 15 Wall. 537.....	14
Runkle v. Southern Pacific Milling Co., 184 Cal. 714.....	20
Scott v. National Bank, 72 Pa. 471.....	14
Smith v. Leavenworth, 15 Kan. 81.....	14
Toomey v. L. etc. R. R. Co., 3 C. B. (N. S.) 146.....	15
United States v. Todd, 53 F. (2d) 1025.....	6
Woo Jan, Ex parte, 228 Fed. 925.....	3

STATUTES

California Warehouse Receipt Act, Sec. 21 (Deering's Cal. Gen. Laws, Act 9059).....	5
----------------------------------------------------------------------------------------	---

TEXTBOOKS

3 Corpus Juris Secundum, p. 899.....	2
Shearman & R. on Negligence, pars. 8-9.....	14
Shearman & R. on Negligence, Sec. 10.....	14
Shearman & R. on Negligence, Sec. 11.....	15
Shearman & R. on Negligence, Sec. 12.....	15
Wharton on Negligence, pars. 576-597.....	14

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vs.

CLYDE W. HENRY,
Appellee.

REPLY BRIEF.

To the Honorable Judges Denman, Healy and Bone:

The appellant, Capitol Chevrolet Company, pursuant to leave granted, herewith files its Reply Brief.

The appellant, Capitol Chevrolet Company, first desires to supply the answers to questions asked by the Court during the oral argument on this appeal and to other questions asked during the argument on the appeal of the appellee herein against the judgment in favor of Henry.

Appellants also wish to answer matters contained in Appellee's Brief, both factually and as to matters of law.

In the afternoon session, after the submission of the cases against Lawrence Warehouse Company and Capitol Chevrolet Company, and during argument on the separate appeal of the Defense Supplies Corporation from judgment in favor of Clyde Henry, Mr. Miller, counsel for Defense Supplies Corporation, while not conceding that the lease between Capitol Chevrolet Company and the owners, Henry & Parella, exonerated the Capitol Chevrolet Company and the Lawrence Warehouse Company nevertheless took the position and conceded that paragraph 10 [R. 331] gave permission to the landlord at all times to enter upon the premises not only for the purpose of examining and inspecting the same, but also to make such repairs and *alterations*¹ therein or any other part of the

¹Alteration is defined as follows:

In 3 C. J. S., p. 899, in defining "alteration" it is said:

"As applied to buildings, a change or substitution in a substantial particular of one part of a building for a building different in that particular; a change or changes within the superficial limits of an existing structure; and installation that becomes an integral part of the building and changes its structural quality; a substantial change therein; a varying or changing the form or nature of such building without destroying its identity."

In *Brill v. Miller*, 140 Appellate Division Reports, New York, at pages 602, 605, "alteration" is defined, in relation to buildings, as:

"This will amount to much more than a mere 'alteration,' which is generally understood as meaning a change or changes within the superficial limits of an existing structure, or a change of form or state which does not affect the identity of the subject. (Century Dict.; *Black River Imp. Co. v. Holl-*

building as said landlord shall deem necessary, and he took the position further that if the Court agreed that the landlord had that right and that his men in entering the premises did so because of that right, that then he sought to hold Henry liable.

Judge Bone asked, during the course of this argument, to clarify just how McGrew came upon the premises.

The testimony shows that McGrew had got a card from Mr. Henry [Exhibit 8—R. 339] giving instructions to the watchmen at the Ice Palace to allow bearer, Mr. Tony Sanchez, to enter with his two men to remove *pipe and equipment* [R. 339]. It was signed Clyde Henry, the owner [R. 339]. Henry was listed as one of the part-

way, 87 Wis. 590; Davenport v. Magoon, 13 Ore. 7; Warren R. R. Co. v. State, 29 N. J. L. 353.)”

In *Ex Parte Woo Jan*, 228 Fed. Reporter 925, at page 941, it is said:

“But the word ‘alter’ is itself broad enough to cover a mere addition. In 3 Enc. L. & P., p. 333, it is defined to mean ‘to make a thing different from what it was.’ Now, a thing is made different from what it was when nothing more is done than to add something to it. So in 2 C. J. 1166, one of the definitions given of this word is ‘to add to,’ in support of which is cited *Adams v. Shelbyville*, 154 Ind. 467, 486, 57 N. E. 114, 49 L. R. A. 797, 77 Am. St. Rep. 484; *Atty. Gen. v. Atty. Gen.*, 20 Ont. 222, 247. In *Adams v. Shelbyville*, he court said:

‘Alter’ is to ‘make otherwise.’ Webster’s Int. Dict. * * *
From the power to alter is necessarily implied the power to add to or diminish.’

And in *Atty. Gen. v. Atty. Gen.*, Boyd, J., said:

“But even in rigorous construction ‘to alter’ would include ‘to add.’ Alteration may be by addition or subtraction.”

It is plainly evident that the removal of the tank was an alteration authorized by the lease which the government approved.

owners of the premises entitled to enter it on plaintiff's Exhibit 10 [R. 340] for the purposes set forth in the lease. The lease gave him power to make alterations as he, Henry, "shall deem necessary" [R. 331]. When this card was presented to Mr. Kenyon he did not grant the permission until he called Mr. Turner, who in turn was the realtor and a person also listed on plaintiff's Exhibit 10, and who was the representative of the owners Mr. Henry and Mr. Parella [R. 336].

It is interesting to note that McGrew testified that when he and Mr. Sanchez first appeared upon the premises, with the card from Mr. Henry, the owner, the guard would not permit them to enter the premises until they had also cleared with Mr. Kenyon and Mr. Kenyon in turn cleared with the owner of the premises pursuant to the requirements of the lease [R. 280, 331].

There was nothing said by Mr. Sanchez or by Mr. McGrew or by anyone as to the type of instrumentality to be used in removing the tank. There is nothing shown in the evidence that Capitol Chevrolet Company ever knew that an acetylene torch was to be used.

The testimony is positive to the contrary that they did not know that an acetylene torch was to be used and that there was no mention of a torch [R. 194].

The removal of pipes and equipment as set out in the card did not bespeak of doing any act inherently dangerous and would not raise the suspicion of a normal and prudent person that such act or conduct would be danger-

ous or require unusual precautions or protection.² The Capitol Chevrolet Company was under a duty under the lease to permit such removal.

Judge Bone in his inquiries in the afternoon pointed out by way of questions that even the possession of an acetylene torch is not an inherently dangerous instrument and the evidence in this case does not show that it was an inherently dangerous instrument in and of itself and in the place it was being used, the engine room, which was not the place where the tires were stored.

Acetylene torches are used every day and are not considered fire hazards unless they are close to inflammable material and material which might quickly ignite (*Reliance Insurance Co. v. Pohlking*, 19 N. E. Section 906). They are not dangerous instruments as a matter of law, but only such in relation to their closeness to gasoline or other highly inflammable materials.

The cases to which Mr. Miller referred in his reargument, to wit, *International S. S. Co. v. Fletcher Co.*, 296 F. 855, C. C. A. (2) only holds that the use of an acetylene torch near inflammable material was negligence. In that case the use in *close proximity* to highly inflammable varnish material was held the proximate cause of damage by fire.

²Section 21, California Warehouses Receipt Act, Deering Calif. General Laws, Act 9059, reads as follows:

“§21. Injury to goods. A warehouseman shall be liable for any loss or injury to the goods caused by his failure to exercise such care in regard to them as a reasonably careful owner of similar goods would exercise, but he shall not be liable, in the absence of an agreement to the contrary, for any loss or injury to the goods which could not have been avoided by the exercise of such care.”

In that case it was admitted that varnish remover was lavishly spread about the place and there was testimony by the inventors of the varnish remover that its composition was of alcohol, benzol and wax which were highly inflammable.

In the present case there was no showing of highly inflammable material in the engine room and there was no showing by the expert or anybody that the "slag", which are the drippings from the use of a cutting torch on metal, would have reached any place that was known to be inflammable or known to have highly inflammable material in it. In the case of *Lancashire Shipping Co. v. Morse Dry Dock & Repair Co.*, 43 F. (2d) 750, at p. 752, it was held:

"The mere fact of an explosion on a vessel undergoing repairs with an acetylene torch would not render the repairman liable by negligence, as a proximate cause of the explosion must be shown." (*Lancashire Shipping Company v. Morse Dry Dock and Repair Company*, 43 F. (2d) 750, 752.)

The same case is also an authority for the proposition that the fact that a repairman engaged in repairing a vessel loaded with gasoline would use an acetylene torch resulting in an explosion was not such an act as could be foreseen.

In the case of *United States v. Todd*, 53 F. (2d) 1025, the Court finds that the tank tops in the five room were loaded with old pipe covering, debris and pieces of canvas, which resulted from respondent's work and which it was under contract obligation to remove (p. 1030). No such condition existed in the case at bar. The engine room, according to all the testimony was absolutely empty. A concrete wall between the engine room and the building

where the tires were stored gave strong precaution against danger.

It should also be borne in mind that McGrew's testimony, which is not contradicted in any respect, is that immediately preceding the discovery of the fire he was on his hands and knees cutting a piece of steel lying parallel to the concrete floor and raised up from that floor 8 inches on blocks and that the point at which he was cutting was at least 8 feet from each side wall and 15 to 20 feet from each of the end walls and "Slag" from a horizontal cut falls directly onto the floor under the cut and could not possibly bounce within the confined space between the metal and the floor and thus reach the side walls.

Mr. McGrew testified that his position during the cutting was on his knees with his hands in direct contact with the metal sometime, or at least close to the metal. [R. 245.] He testified he did not feel any heat, either through his knees or through his hands (p. 245). He testified further that the metal was not warmer than prior to any cutting operations that he performed. He said that he cut almost in a direct line, holding the torch at right angles to the metal cut that was being made and he moved along with the torch. He said that he felt no heat either through his knees or through his hands. [R. 245.]

Judge Bone asked during the afternoon session whether this was an *Erie v. Tompkins* case (304 U. S. 64), referring, of course, we assume, to the duty of the Federal Court to follow the State Court's interpretation of its own laws.

The contracts in this case between the parties and approved by the Government and its agents places the duties of the Lawrence Warehouse and the Capitol Chevrolet

Company only as construed by the laws of the State of California. "Your general responsibility for the care and protection of the tires will be limited to such care as is required by laws governing warehouses in your state and to the exercise of ordinary care on your part." [R. 314.]

Of course, the court would also be bound by the decision of *Erie v. Tompkins* (304 U. S. 64).

Under the California rule, the burden of proof was on the plaintiff to show the negligence of the defendants as found by the trial court which was as follows:

"On April 9, 1943, defendants Lawrence Warehouse Company and Capitol Chevrolet Company failed and omitted to exercise reasonable care and diligence for the protection and preservation of said goods so deposited and stored by plaintiff in this, that said defendants negligently permitted the use of said torch on said premises and negligently failed and omitted to see that it was used in a careful manner, and to provide adequate protection for said premises and said goods against the use of said torch, and maintained such premises and said goods in a negligent and carless manner so as to permit them to become ignited and destroyed by fire.. By reason of such negligence and carelessness said premises and plaintiff's said goods were consumed and totally destroyed by fire." [R. 81.]

The trial court jumped from the admission of the workman to the engine room pursuant to Henry's lease authority to another conclusion without supporting evidence. 1. That the defendants negligently permitted the use of said torch on said premises. There is not one word of evidence in the record that the defendants knew or permitted the use of said torch on said premises, but, on the contrary, the evidence is only that the watch-

man, appointed pursuant to the specific directions of the Defense Supplies Corporation and having no responsibility to the defendant, Capitol Chevrolet Company, was the only one who had any knowledge outside of McGrew and his helper that a torch was to be used.

The court also jumped at a conclusion that there was no adequate protection for said premises and said goods against the use of the torch when under the specific oral agreement between the Defense Supplies Corporation and the defendants, the control of protection for said premises by way of watchmen or any other persons present on the premises was directly and totally governed and controlled by the plaintiff, who specified to the man and to the detail just how the goods were to be stored and who was to protect or guard it, and who and what was to be on the premises. [R. 315, The Government's Exhibit 2; Plaintiff's Exhibit 9, R. 339, and Plaintiff's Exhibit 10, R. 340.]

It is interesting to note that the plaintiff did provide and direct that there should be nine tire pilers and stackers admitted [R. 341], but the plaintiff itself directed the hours and time when these men worked and the character of their work; and, when the fire occurred they had all gone to lunch, and the plaintiff itself was not only in control of the situation but it was therefore guilty of contributory negligence in not having enough men around to observe the fire and assist in its extinction after it started, since it was in the sole control and direction of all agents and personnel that could provide "adequate protection for said premises and said goods against the use of said torch." [R. 286, 339, 340.]

The burden was on the plaintiff to show by confident proof that the defendant could have done anything more

than it did do in maintaining proper and preventive look-outs when the plaintiff itself directed who should be hired, how many men should be hired, and who should be present. This certainly failed to meet the burden of proof cast upon the plaintiff.

Bartholomai v. Owl Drug Co., 42 Cal. App. (2d) 38.

The cases cited by the appellee in respect to acetylene torches are from other jurisdictions, to-wit: Illinois, Louisiana and New York.

The appellee concedes that it made no showing whatsoever as to the condition of the warehouse itself, as to whether there were fire precautions of kinds of hose, a sprinkler system or anything else within it. Judge Denman frequently commented about this situation.

It would be no comfort to Defense Supplies Corporation to say that this equipment was there but not used. This was not the alleged negligence found by the trial court. Furthermore the building between the engine tank and the place where the tires were stored was locked, and there was no accessibility, besides, except to the watchman and those designated by the plaintiff to be permitted in the place where the tires were stored, the only person on the premises to guard against fire was the watchman and according to express terms of the contract and the express designation by the Government was the only person required or permitted actually to be upon the premises to guard it or self-guard it from fire. He had complete dominion and control and was responsible to no one except his own superior, The Burns Detective Agency. He took no orders from the Capitol Chevrolet Company or the Lawrence Warehouse Company. The watchman

was from an agency approved and paid by the Government for the specific purpose of safe-guarding the materials. [R. 279-80; 286-88.]

The list of people who were permitted in the premises was furnished to Kissell by Mr. Harris of The Burns Detective Agency [R. 286], and is the list constituting Exhibit 10, and which was introduced in evidence as a Plaintiff's Exhibit by Mr. Miller on behalf of the Defense Supplies Corporation as a correct list of the persons permitted by the Defense Supplies Corporation to go upon the premises.

The list of names was furnished by the Defense Supplies Corporation. [R. 198.]

The duties of Capitol Chevrolet Company.

The duties of Capitol Chevrolet Company are set forth both in Section 1858-e of the Code of Civil Procedure of the State of California, and Section 21 of the Uniform Warehouse Act of California, and each of these required only that Capitol Chevrolet Company exercise the duty of an ordinarily prudent person under same or similar circumstances. (See footnote 2 for Section 21. Section 1858e is quoted on page 4 opening brief of Capitol Chevrolet Co.)

Capitol Chevrolet Company acted normally and prudently through its employees in permitting McGrew to come upon the premises pursuant to the requirements of the lease. When it was told that the only thing that was to be done was to *alter* the premises by taking out pipe and equipment, this was the right which the landlord had under the lease and Capitol Chevrolet Company would have been liable to the landlord had it not permitted them

to do what the lease permitted them to do. Therefore, there could be no negligence in doing what its contract required it to permit to be done under the express terms of the lease and which lease was in turn approved by the government, Defense Supplies Corporation, at the time of the making of the same. Therefore, Capitol Chevrolet Company cannot be held to be negligent for permitting McGrew to come upon the premises as argued by Mr. Miller during the afternoon session, nor has it been contended that Capitol Chevrolet Company was negligent in permitting McGrew to come upon the premises in so far as the opinion of the trial court was concerned. The negligence which that Court found, and upon which it based its opinion, is that it was Capitol's duty to anticipate fire hazards and maintain proper and preventive lookouts. [R. 171.] Capitol Chevrolet did maintain proper and preventive lookouts in accordance with express terms of the supplementary contract which required Capitol Chevrolet Company to rely on Burns Detective Agency as the proper and preventive lookout specifically so designated by the Defense Supplies Corporation, and which designation eliminated any and all other lookouts. The trial court further held that Capitol's act in storing valuable inflammable material in a wooden structure outside the city limits and far beyond speedy access to the City fire equipment was negligent. However, the location was picked by the Defense Supplies Company with full knowledge of its location outside the city limits. Furthermore, there is nothing in the record to indicate that the Sacramento County fire fighting equipment, which responded to the fire, was in anywise inferior to the Sacramento fire fighting equipment. The only delay was caused by the fact that the watchman not realizing that

the building was outside the city limits, first called the City Fire Department and was referred by them to the County Fire Department. [R. 282.] And other employees specifically designated by the Defense Supplies Corporation for employment and admission on the premises were absent.

It was plaintiff's "burden of proof" to prove how the fire occurred. This it failed to do. A judgment cannot be based on speculation. *Bartholomai v. Owl Drug Co.*, 42 Cal. App. (2d) 42.

The evidence as to the source of the fire is extremely doubtful and there were only two men on the premises, to wit, McGrew and Kissell, the watchman, when the fire broke out. The tire pilers had all gone to lunch.

After attempting to put out the fire by throwing some 15 gallons of water upon it, McGrew ran all the way around the building to notify the watchman. The watchman then spent the next ten minutes calling the fire department. By the time he had done this, he observed the fire within the main building where the tires were stored. Meantime McGrew ran back to the engine room and dragged out his oxygen cylinders to keep them from exploding. It is extremely doubtful if he and McGrew could possibly have put out the fire at that stage with any sort of fire fighting equipment and they did everything possible to summon the proper fire fighting department to cope with the situation.

Bearing in mind that the plaintiff had control of the personnel on the premises and their number and specific duties, in order for there to have been negligence for the non-use of fire fighting equipment in the main building, it would have been necessary to show that there were

sufficient persons present to effectively put out the fire with such equipment under the conditions. No attempt was made by the plaintiff to introduce any such evidence. It was the plaintiff who dictated just how many men there should be on the premises and just what their duties should be. It was, therefore, the plaintiff who was guilty of contributory negligence if negligence there was in not having men enough on the premises to handle the situation. Let us suppose that a fire had occurred in the middle of the night when only the watchman was present. Under such circumstances it is obvious that one watchman could not have effectively used a sufficient quantity of fire fighting equipment to put out a fire of the size that this fire had gained before it was discovered and his failure to do so would not be negligent. To be held liable the negligence of Capitol Chevrolet Company must be the proximate *cause* of the injury. Proximate cause is a cause from which a man of ordinary experience and sagacity would foresee that the result which if there was any evidence of negligence might ensue.

The negligence of the warehouseman must be the cause of the injury. (Wharton, para. 576-597; *Roberts v. Gurney*, 120 Mass. 33; 15 Wall. 537; Shearman & R. on Neg., para. 8-9.) Proximate cause is a cause from which a man of ordinary experience and sagacity could foresee that the result might probably ensue. (Shearman & R. on Neg., sec. 10; *Ill. C. R. R. Co. v. Benton*, 69 Ill. 174; *Smith v. Leavenworth*, 15 Kan. 81; *Scott v. National Bank*, 72 Penn. St. 471.) If there be no evidence of negligence, or a mere scintilla of evidence, the Court should grant a nonsuit. (*Cotton v. Wood*, 8 C. B. (N. S.) 568; *Brooks v. Somerville*, 106 Mass. 271; *Denny v. Williams*, 5 Allen, 1; *McCaig v. Erie R.*

R. Co., 8 Hun. 599; 104 Mass. 71; *Toomcy v. L. etc. R. R. Co.*, 3 C. B. (N. S.) 146-150; *Cornman v. E. C. R. Co.*, 4 H. & N. 781; L. R., 3 App. Cas. 1155; 99 Mass. 612; *Briggs v. Oliver*, 4 Hurl. & Colt. 403; Shearman & R. on Neg., Sec. 11; 49 Cal. 257.)

Here there is no evidence tending to show that the defendant or its servants were negligent, or that its or their negligence was the approximate cause of the injury complained of. We have seen that in a case of this kind, the law will not presume negligence. We have also seen that the law emphatically condemns "surmise and imagination," when the verdict can rest upon nothing else. If, then, presumption, surmise, imagination, be excluded, the plaintiff's case rests alone, upon the facts, that there was a fire, and consequent loss, and the case has not, for the plaintiff, advanced beyond the point where it was when the complaint and answer were read to the Court and jury. We have also seen that "the burden of proof in an action upon negligence, always rests upon the party charging it." * * * And that, "It is not enough for him to prove that he has suffered loss by some event which happened upon the defendant's premises, or even by the act or omission of the defendant." He must also prove that the defendant in such act or omission violated a duty resting upon him. (*S. & R.*, on Neg., Sec. 12.)

In *Wilson v. Southern Pacific R. R. Co.*, the Court said at page 172;

"But if it appears that the property, when demanded, was consumed by fire, the burden of proof is then on the bailor to show that the fire was the result of the negligence of the warehouseman. (*Harris v. Packwood*, 2 Taunt. 264; *Beardslee v. Rich-*

ardson, 11 Wend. 26; *Browne v. Johnson*, 29 Tex. 43; *Lamb v. Camden and Amboy R. R. Co.*, 46 N. Y. 271; *Jackson v. Sac. Val. R. R. Co.*, 23 Cal. 269.)

The negligence of the appellant, as the proximate cause of the loss of the property by fire, thus became the essential fact to recovery; and the burden of proof was upon the plaintiff in the action. It was incumbent on him to prove that the defendant had, by some act of omission, violated some duty, by reason of which the fire originated; or that some negligence or want of care, such as a prudent man would take under similar circumstances of his own property, caused or permitted, or contributed to cause or permit, the fire by which the property was destroyed."

In *Bartholomai v. Owl Drug Co.*, 42 Cal. App. (2d) at page 42, the Court said:

"The mere fact that the fire occurred is insufficient to raise an inference of negligence on the part of respondents. No evidence was produced which tended to prove that the false ceiling was erected by or under the direction of respondents, or that they had knowledge of the inflammable nature of the planks with which it was constructed. It was proved that the welding apparatus was being operated by respondent McDonald on a platform above the ceiling at the time the fire broke out, this witness describing the beginning of the fire as a rising of smoke through and between the planks which com-

prised this false ceiling, but there was no evidence tending to prove that he operated the welding apparatus in a negligent manner.³

Before respondent could be held to answer in damages for the injuries suffered by appellant, it was incumbent upon the latter to assume the burden of proof and show by a preponderance of the evidence that the negligence of respondents was the proximate cause of the fire. A judgment cannot be based upon guesses or conjectures. (*Reese v. Smith*, 9 Cal. (2d) 324, 328 [70 Pac. (2d) 933], citing *Puckhaber v. Southern Pac. Co.*, 132 Cal. 363 [64 Pac. 480].)”

Under the rule thus stated, Defense Supplies Company failed to prove its burden and taking the case as a whole there was no preponderance of evidence as Mr. Miller contended showing negligence on either the part of Capitol Chevrolet Company or Lawrence Warehouse. Neither in the opinion of Judge Goodman, in the brief submitted on behalf of the government, nor in the argument was any specific act of negligence or act of omission constituting negligence on the part of Capitol Chevrolet Company or Lawrence Warehouse Company called to the attention of the Court.

³There is no proof by the plaintiff that McGrew operated his equipment in the engine room in a negligent manner.

Mr. McGrew said he spread two 5-gallon buckets of water on the cement and he observed the condition of the floor and that there was nothing on the floor in the nature of combustible material. [R. 234-235.]

He did not observe the concrete popping up during his cutting operation. [R. 235.]

During the course of his reargument of the case in the afternoon session, Mr. Miller stated that McGrew not having been a person named by the Defense Supplies Company in Plaintiff's Exhibit 10, Capitol Chevrolet following the terms of its contract, as amended by Plaintiff's Exhibits 9 and 10, was negligent in permitting McGrew upon the premises. The answer to that proposition is a simple one and that is that the government having approved the lease under which the owner reserved the right to enter the premises for repairs, alterations and other purposes, need not do that work himself, but could obviously have his employees enter the premises to make the necessary alterations or changes. It is a perfectly simple proposition that a lease permitting a landlord's entry for such purposes as are outlined in paragraph 10 of the lease does not mean that only the landlord himself as an individual may enter to perform those tasks, but that his agents or representatives in the performance of his work may have a right to do so. It is a matter of common knowledge that an owner of a building does not and need only generally make the alterations in a building himself, but has workmen or employees or independent contractors do it for him and these persons carry the same authority as he does. It should also be borne in mind that the final entry of McGrew and of Elmore, his helper, was permitted by the Burns Detective Agency watchman, who was one of the watchmen furnished by the agency approved and paid for by the government and taking orders from no one in Capitol Chevrolet Company.

Mr. Baxter of the Defense Supplies Corporation was the person who was in immediate contact, in charge of the warehousing or storing of tires in Sacramento, and it was

he who made the investigation which led to the storage of tires in the Ice Palace. [R. 142.]

He made a report to the Defense Supplies Corporation upon all conditions at the Ice Palace. He knew all the facilities of the Ice Palace at the time of its selection and how many men it would take to guide and to render it reasonably safe so far as the interest of the Defense Supplies Corporation was concerned.

It must have been assumed by the Defense Supplies Corporation that with nine tire pilers working that there would be plenty of watchmen at least during the day time. That the Defense Supplies Corporation did not provide for a shift for these men to go for lunch certainly is evidence of contributory negligence on their part.

The record does not disclose how near or how far the Sacramento Fire Fighting Department was located from these premises. This was the burden of proof on the plaintiff. If the Sacramento Fire Department was just a short distance away and was able to respond within a minute or two of any notification of fire or even within five or ten minutes, and it is not shown that such service was inadequate to the protection of this premises then there is no negligence on the part of defendants and the plaintiff has missed the burden of showing this on the part of the defendant.

Any fact relating to Mr. Baxter, of the Defense Supplies Corporation, in selecting the placing the requirements of what he thought was necessary upon the premises must be presumed to have taken all of this into consideration. It might be inferred also that the County Sacramento Fire Department was available quickly to at-

tend to any possible fire on the premises in that he only provided watchmen for the premises at night and that was the only person required or permitted to be upon the premises at night. It must be presumed that he considered these factors in determining how many men should be on the premises to watch or guide it or to fight any possible fire.

We notice that the floors in the engine room as well as the floors in the building were of concrete. There is no evidence of inflammability or inflammable materials in the engine room. Tires are in and of themselves not ordinarily considered inflammable although subject to destruction by fire. Nothing was in the engine room that could burn except two benches not near the work being done.

In *Runkle v. Southern Pacific Milling Co.*, 184 Cal. 714, the Supreme Court of California held in a decision which is binding on this Court because of its interpretation of the California law, that it is incumbent on the plaintiff in a suit against the warehousemen by one who has lost his goods through fire which destroyed the warehouse to "sustain the burden of showing defendant's negligence." This case which was cited by the appellee points out that the watchman in that case was intoxicated while in the scope of his employment and that negligence resulted from his inability to watch the premises properly because of that state of facts. In the present case the watchman quite contrary to the *Runkle* case was alert; he stopped the men from coming onto the premises when they first sought to come on, he later permitted them to come on with proper authority under the lease and cautioned them to take care of any danger against fire. He, and he alone, knew what they were going to do and how

they were going to do it. As an independent contractor named by Defense Supplies Company he had no duty to Capitol Chevrolet Company and did not inform Capitol Chevrolet Company of any of these facts. As an independent contractor paid by the government he had no duty. If he had been an employee of Capital Chevrolet Company and responsible to them he would have reported these facts to them. Instead, however, under the terms of his employment and payment he had no duty to do so and Capitol Chevrolet was entirely exonerated because of this superior control by the plaintiff over the instrumentality of precaution.

The Reply Brief of appellant, Lawrence Warehouse Company, argues other points and we adopt their argument as though fully set forth here.

In the course of the morning's argument, Judge Denman in the course of a question, assumed that the Burns Detective Agency were general watchmen. Judge Bone called attention to the trial court's note, on page 72 of the Record, to the effect that the armed guard service was purely an additional and independent protective activity to prevent pilferage of the tires.

In answer thereto we state that the trial court is completely in error. There is no evidence in the Record to indicate that the Burns Detective Agency's activities were in anywise so limited. [R. 285-6.] The stipulation of counsel for plaintiff contains no such restriction nor is there anything in the evidence of the guard himself to indicate that he felt his duties were so limited. The testimony is quite to the contrary that he had general supervision and control, taking his orders from the head of the Burns Agency. His activities with regard to ad-

mitting McGrew and otherwise demonstrated that fact. He cautioned McGrew and helper to be careful of fire, and they said they were. [R. 281.]

There was no expert testimony as to the cause of the fire, nor whether any sparks from the acetylene torch could possibly have caused the fire nor that McGrew's work was done carelessly or unsafely. The government produced an expert, but contrary to Mr. Miller's suggestions was not stopped by the Court from asking any questions. [R. 270-74.] The expert, Gus Johnson, testified he worked for a mining company and supervised acetylene torches by others. He was asked a question about whether an acetylene torch with the cutting flame directly downward toward the plate "would the heat from the torch or the burning metal, set fire to or ignite wood, grease, metal, tar, rags, or any other inflammable material that might be lying on the floor?" [R. 273.] The witness answered "Yes" and he was asked a few other questions about any inflammable material within 8 inches of where he was cutting. After which Mr. Miller concluded with him. This certainly did not meet any burden of proof showing the cause of the fire or that it was the result of negligent use of a torch or of any negligence in the removal of the pipe.

There was a limitation on the "expert's" cross-examination by the defense. But nothing was adduced which was relevant or material in determining the cause of the fire in this case.

No other testimony was offered to support the burden of proof as to how the fire occurred. The plaintiff made assumptions and relied on the trial court to guess, speculate and conjecture on the cause of the fire in its favor.

In conclusion we wish to point out that in the original brief submitted by Lawrence Warehouse Company two propositions were argued. The first being in reference to the inference of negligence drawn by the trial court, and the second with reference to the obvious conflict between the findings of fact. Neither of these propositions have been answered by the plaintiff either in its Reply Brief or in argument. We believe each of these propositions are also necessarily fatal to the government's case.

Mr. Miller urged the Court to be consistent. Judge Healy commented that the plaintiff should also be consistent, but since the plaintiff could not be consistent under the facts and proceedings of this case, it has blown hot and cold. It asks this Court to uphold its contentions which it has failed to prove by any evidence.

Wherefore, appellant Capitol Chevrolet Company prays that this Honorable Court reverse the judgment of the court below and hold that the Capitol Chevrolet Company as well as Lawrence Warehouse Company were not negligent under the facts of this case.

Respectfully submitted,

MORRIS LAVINE,

Attorney for Appellant Capitol Chevrolet Company.



No. 11,418

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

LAWRENCE WAREHOUSE COMPANY (a corporation),
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

CAPITOL CHEVROLET COMPANY (a corporation),
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

V. J. MCGREW,
Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,
Appellee.

DEFENSE SUPPLIES CORPORATION,
Appellant,

vs.

CLYDE W. HENRY,
Appellee.

PETITION OF APPELLANT,
LAWRENCE WAREHOUSE COMPANY,
FOR A REHEARING.

W. R. WALLACE, JR.,

W. R. RAY,

WILLIAMSON & WALLACE,

310 Sansome Street, San Francisco 4, California,

*Attorneys for Appellant and Petitioner,
Lawrence Warehouse Company.*

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IN THE
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LAWRENCE WAREHOUSE COMPANY
(a corporation),

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DEFENSE SUPPLIES CORPORATION,

Appellant,

VS.

CLYDE W. HENRY,

Appellee.

PETITION OF APPELLANT,
LAWRENCE WAREHOUSE COMPANY,
FOR A REHEARING.

To the Honorable Francis A. Garrecht, Presiding Judge, and to the Honorable Associate Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Appellant, Lawrence Warehouse Company, hereby petitions the Court for a rehearing in the above entitled cause upon the ground that the Court erred in its decision as to matters of law and fact.

In support of its petition, petitioner respectfully shows:

The trial Court found that the fire resulted from the acts of the defendant, McGrew. This Court in its opinion states:

“To begin with, we are obliged to accept as true the finding that the fire originated from the use by McGrew of an acetylene torch in the cutting up of a steel tank in the engine room.”

The trial Court and this Court have both found that McGrew was given authority to enter the premises by the defendant, Capitol Crevrolet Company, and that that company gave such authority in supposed compliance with the terms of its lease with the defendant, Henry, the owner of the premises.

The record is perfectly clear that this defendant, Lawrence Warehouse Company, had no knowledge of the request for entry or of the fact of entry, and it was not even charged that Lawrence in any way authorized the entry. Had no entry been authorized by Capitol Chevrolet, no fire would have occurred. Therefore, the act of permitting McGrew to enter the premises with the blow torch and of permitting him

to cut up the steel tank in the premises was the actual proximate cause of the damage. The essential "dereliction" of the Capitol Chevrolet, from which the damage resulted, was the act of permitting entry to cut the tank with the blow torch.

In its briefs and upon the oral argument, your petitioner urged that it could not be held liable for this dereliction on the part of the Capitol Chevrolet for the reason that the act performed by Capitol Chevrolet was clearly outside the authority of Capitol Chevrolet as agent and was performed pursuant to the terms of its leasehold agreement with its landlord and did not even purport to be performed in accordance with or under the terms of the agency agreement.

In its briefs Lawrence set forth the authorities delineating the doctrine of *respondeat superior*. From those authorities it is clear that before a principal may be held for the act or omission of its agent, that act or omission must be within the scope of the agent's authority.

When a servant acts without any reference to the service for which he is employed, and not for the purpose of performing the work of his employer, but to effect some independent purpose of his own, the master is not responsible for either the act or omission of the servant.

Stephenson v. Southern Pacific Co., 93 Cal. 558, 29 Pac. 234.

Also, we pointed out that the trial Court had failed to find that the dereliction of Capitol Chevrolet was within the scope of its authority as agent, and that

such a finding is essential to support the trial Court's judgment.

In its opinion this Court states:

"Now if Capitol was negligent in safeguarding the goods it follows as a matter of course that its dereliction is imputable to its principal, Lawrence. The latter argues that Capitol's negligence, if any, was not shown to be within the scope of its authority as an agent, and that there was no finding that it was. While the findings are not specific in this respect, the trial court's opinion shows that the decision as against Lawrence was grounded on imputed negligence. The facts of the case and the terms of the agency agreement fully support that conclusion."

We respectfully suggest that the above quoted statement is erroneous as a matter of law.

The first quoted sentence states if Capitol was negligent in safeguarding the goods, it follows as a matter of course that its dereliction is imputable to its principal. That statement can be true as a matter of law only if the dereliction of the agent, which constituted the negligence, was such an act or omission as came within the scope of the agent's authority. The Court takes cognizance of this rule in its next statement:

"The latter (Lawrence) argues that Capitol's negligence, if any, was not shown to be within the scope of its authority as an agent, and that there was no finding that it was."

Rule 52a of the Federal Rules of Civil Procedure provides:

“In all actions tried upon the facts without a jury the Court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of appropriate judgment;”

The Findings of the trial Court are silent upon the major issue of whether or not the dereliction of Capitol Chevrolet, in permitting McGrew to enter the premises and cut up the steel tank with a blow torch, was within the scope of its authority as agent. In this connection this Court in its decision states:

“While the findings are not specific in this respect, the trial Court’s opinion shows that the decision as against Lawrence was grounded on imputed negligence.”

Presumably, the Court intended by this statement to indicate that the Opinion of the trial Court might be used to supply the missing and essential Finding. If so, this Court is, in effect, adopting the trial Court’s Opinion as a Finding and thus attempting to supply the deficiency.

“In this case a reading of the trial Judge’s opinion reveals a full discussion and treatment of the major factual issues, which leaves no doubt as to which facts the Court accepted and relied upon in rendering its decision. These we can treat as findings of fact and so do.”

Hazeltine Corp. v. General Motors Corp., 131 Fed. (2d) 34.

In the case at bar, however, the Opinion of the trial Court is as silent as its Findings upon the essential question of whether the act of the agent in per-

mitting McGrew to enter and cut up the tank with a blow torch was within the scope of its authority as agent. Even if this Court intended to adopt the trial Court's Opinion as additional Findings such an adoption could not supply the fatal deficiency. And the negligence of the agent cannot be "imputed" to the principal in the absence of such a finding.

Furthermore, it is perfectly clear why no such statement is made in the trial Court's Opinion and why no such Finding was made, for all of the evidence shows that the permissive entry and the acts performed by McGrew pursuant to that entry, if performed with the consent of Capitol Chevrolet, were founded not upon its agency for Lawrence but upon its relationship as tenant of the owner, Henry. Had the Court, therefore, made such a Finding, it would have been without support in the evidence and contrary to the evidence. We therefore respectfully suggest that the exception to Rule 52a, stated in the *Hazeltine Corporation* case, cannot be availed of in this case and that in the absence of the essential finding, this Court should reverse the judgment against Lawrence.

We believe that this Court has followed the error of the trial Court. We take it there can be no dispute of the legal principle that the negligence of an agent can only be imputed to the principal when and if the negligent act is within the scope of the agent's authority. Therefore, to state that in the absence of a finding the trial Court's Opinion shows that the decision against Lawrence was grounded only on imputed negligence merely begs the questions.

The legal proposition argued in the briefs and again upon the hearing was that the negligence of the agent could not be imputed to Lawrence because the evidence was clear that the act of the agent for which the principal is charged was an act outside of the scope of the agent's authority.

The Court then concludes its discussion of this phase of the case:

“The facts of the case and the terms of the agency agreement fully support that conclusion.”

The “conclusion” referred to is “that the decision as against Lawrence is grounded on imputed negligence.”

The error of the trial Court, and we submit the error of this Court, was in overlooking the rule that negligence of the agent may only be imputed to the principal where the act was within the scope of the agent's duties.

This Court further states in its opinion:

“The corporation furnished to Lawrence and Capitol a list of named persons whom it authorized to be admitted to the premises. Though some point is sought to be made of this circumstance, we fail to see significance in it. Capitol and its employees were not excluded, and there is no evidence that the actual custodianship of either bailee was in any way interfered with.”

This statement we believe also to be erroneous as a matter of law. The list of named persons effectively excluded every employee of Lawrence Warehouse Company from the premises. To say that such an

exclusion did not interfere with the actual custodianship of Lawrence seems to us to state a most unusual and new proposition of law. It is, in effect, to state that a bailor may exclude a bailee from the premises in which goods are stored without interference with actual custodianship. Here a principal was excluded from the premises of its agents by the act of the depositor, yet the principal is held by imputation for the act of the agent when even the normal control of the agent by the principal was made impossible by the depositor.

We respectfully submit that in view of the admitted absence of any negligence on the part of Lawrence and in view of the fact that all of the evidence shows that the act of the agent was an act outside of the scope of its authority, and in the absence of any finding or statement of the trial Court to the contrary, the judgment against Lawrence Warehouse Company should be reversed, and we most respectfully request a rehearing.

Dated, San Francisco, California,
December 31, 1947.

Respectfully submitted,
W. R. WALLACE, JR.,
W. R. RAY,
WILLIAMSON & WALLACE,
Attorneys for Appellant and Petitioner,
Lawrence Warehouse Company.

CERTIFICATE OF COUNSEL.

We hereby certify that in our judgment the foregoing petition for rehearing of Lawrence Warehouse Company is well founded and that it is not interposed for delay.

Dated, San Francisco, California,
December 31, 1947.

W. R. WALLACE, JR.,

W. R. RAY,

*Attorneys for Appellant and Petitioner,
Lawrence Warehouse Company.*

WILLIAMSON & WALLACE,
Of Counsel.

United States
Circuit Court of Appeals

For the Ninth Circuit

LAWRENCE WAREHOUSE COMPANY (a corporation),

Appellant,

vs.

DEFENSE SUPPLIES CORPORATION,

Appellee.

CAPITOL CHEVROLET COMPANY (a corporation),

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V. J. McGREW,

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vs.

DEFENSE SUPPLIES CORPORATION,

Appellee.

DEFENSE SUPPLIES CORPORATION,

Appellant,

vs.

CLYDE W. HENRY,

Appellee.

Petition of Appellee Defense Supplies Corporation
and Reconstruction Finance Corporation
for a Rehearing

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Subject Index

	Page
I. The Court Erred in Considering the Failure to Substitute a Matter of Jurisdiction Rather than of Procedure	2
II. The Court Erred in Considering Defense Supplies Corporation Non-Existent at the Time Judgment Was Entered	5
III. The Court Erred in Disregarding Appellants' Waiver of the Error.....	6
IV. The Court Erred in Relying on Decisions Involving Public Officials Which Are Not in Point Here.....	9
Certificate of Counsel.....	11

Table of Authorities Cited

	Pages
CASES	
Cavers v. Sioux Oil & Ref. Co. (Tex.), 43 S.W. 2d 578.....	9
Fix v. Philadelphia Barge Company, 290 U.S. 530.....	7
Fleming v. Goodwin, 165 F.(2d) 334 (C.C.A. 8).....	10, 11
Gaynor v. Metals Reserve Company (.....F. (2d), de- cided March 25, 1948).....	6
L. Bucki & Son Lumber Co. v. Atlantic Lumber Co., 128 Fed. 332 (C.C.A. 5), certiorari denied 193 U.S. 672.....	8
LeCrone v. McAdoo, 253 U.S. 217.....	9
Mathison v. Payne, Director General of Railroads (Sup. Ct. of N. J.), 119 Atl. 771.....	9
Payne v. Industrial Board of Illinois, 258 U.S. 613.....	9
R. Piel Gin Co. v. Ind. Farmers' Gin Co. (Tex.), 257 S.W. 630	9
Reardon v. Balaklala Copper Co., 193 Fed. 189.....	4
Trounatine, et al. v. Bauer, Ponge & Co., Inc., et al., 144 F.(2d) 379 (C.C.A. 2).....	8
Union Sugar Co. v. Hollister Estate Co., 3 Cal. (2d) 740, 744-5	8
United States v. Curran, 276 U.S. 590.....	7, 9
United States v. Koike, 164 F.(2d) 155 (C.C.A. 9).....	11
U. S. v. Butterworth, 169 U.S. 600.....	9, 10
U. S. Ex Rel. Anthony Volpe v. S. D. Smith, 289 U.S. 422, 77 L.Ed. 1298.....	9
W. P. Brown & Sons Lumber Co. v. Commissioner, 38 F. (2d) 425, 429 (C.C.A. 6), aff'd 282 U.S. 283.....	8

STATUTES

United States Code:	
Title 28, Section 777.....	3
Title 28, Section 780.....	7

TEXTS

53 C. J. S. 958, et seq.....	8
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United States
Circuit Court of Appeals
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LAWRENCE WAREHOUSE COMPANY (a corporation),	<i>Appellant,</i>
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DEFENSE SUPPLIES CORPORATION,	<i>Appellant,</i>
-------------------------------	-------------------

vs.

CLYDE W. HENRY,	<i>Appellee.</i>
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**Petition of Appellee Defense Supplies Corporation
and Reconstruction Finance Corporation
for a Rehearing**

*To the Honorable Francis A. Garrecht, Presiding Judge,
and to the Honorable Associate Judges of the United
States Circuit Court of Appeals for the Ninth Circuit:*

Appellee, Defense Supplies Corporation and Reconstruction Finance Corporation hereby petition the Court

for a rehearing of their motion for the substitution of Reconstruction Finance Corporation as appellee in the place of Defense Supplies Corporation, and the motion of appellants, Lawrence Warehouse Company and Capitol Chevrolet Company for dismissal of the action, upon the ground that the Court erred in its decision on said motions in the following respects:

I.

THE COURT ERRED IN CONSIDERING THE FAILURE TO SUBSTITUTE A MATTER OF JURISDICTION RATHER THAN OF PROCEDURE.

The Court's decision is based on the contention that the failure to substitute Reconstruction Finance Corporation as a party within the twelve-month period provided for in the Act dissolving Defense Supplies Corporation (59 Statutes 310) deprived the Trial Court of jurisdiction to render judgment. The majority of this Court hold that in spite of the fact the issues were framed and all testimony taken prior to the dissolution of plaintiff, the mere failure to substitute made the Trial Court powerless to render judgment. The majority of this Court further hold that this Court is now powerless to remedy the defect by substituting the proper party plaintiff. This holding is made in spite of the fact that the Act of dissolution expressly provides against abatement. The Court has read into the Act a provision that, in the event substitution is not made, then both the trial court and the appellate court lose all power to act in the matter except to dismiss the action, and such loss of power relates back to the date of dissolution. It is submitted that the Act

contains no such provision and that Congress could not have intended such a result.

By the passage of the Act Congress intended to and did provide for the continued existence of the dissolved corporation for the purpose of litigation. Congress further provided for a procedure to be followed to obtain substitution of parties and gave the court the power to dismiss an action where the necessity for its continuance to determine the issues is not shown. The Act contains no provision depriving the trial court or this Court of the power to act in the event the procedure for substitution is not followed.

The plaintiff, Defense Supplies Corporation, having been continued in existence for the purpose of litigation, and the Trial Court having seen fit to render judgment in its favor, that judgment cannot now be declared void because of lack of jurisdiction, nor can the Act, by any stretch of the imagination, be considered to deprive this Court of the power to remedy the defect of failure to substitute, a power which this Court has under the provisions of Section 777 of Title 28 of the *United States Code*. If Congress had intended such a result, it is only reasonable to say that it would have expressly so provided in the Act of dissolution. It should be borne in mind that whether or not any substitution is made, the real party in interest remains the same, i.e., the United States. We are dealing here with two agencies of the United States, and the substitution of one for the other is in substance the substitution of names only, the real party plaintiff remaining the same.

The majority of the Court stress the provision of the Act of dissolution providing that Reconstruction Finance

Corporation shall perform the functions of Defense Supplies Corporation. This provision would be of some importance if we were dealing with the issue of whether certain functions can be exercised by Reconstruction Finance Corporation. There is no such issue here, however. The issue is whether or not the judgment of the Trial Court is a valid one. Whether or not the wrong party defended the judgment can have nothing to do with the validity of the judgment, which was entered by the Trial Court while the corporate plaintiff still had existence, at least for the purpose of preserving its status as a party.

The majority of the Court also state that if the failure to substitute is a matter of procedure only that can be disregarded, then the failure to file a notice of appeal is also a mere matter of procedure and can be disregarded. (See bottom of page 3 of this Court's Opinion.) It has long been held of course that the failure to file a notice of appeal within the time allowed by statute deprives the appellate court of jurisdiction to hear the appeal. This is the interpretation of an entirely different statute involving different considerations. The two cases are not comparable and a decision with regard to one can have no bearing on the other.

The majority of the Court misstate the ruling in *Rear-don v. Balaklala Copper Co.*, 193 Fed. 189. (See page 4 of this Court's opinion.) In regard to that case the majority state that "No question of substitution of the personal representative was discussed and it was assumed that the father under the California law had the right to bring the action." This is in error, as the sole issue in that case was whether it was proper to substitute the

personal representative as party plaintiff in the place of the father. That case is direct authority that a substitution can be made where the action is maintained by the wrong party without requiring the dismissal of the action and the filing of a new suit. In other words, it is direct authority that under circumstances similar to the present case, substitution is a matter of procedure only and not jurisdictional.

II.

THE COURT ERRED IN CONSIDERING DEFENSE SUPPLIES CORPORATION NON-EXISTENT AT THE TIME JUDGMENT WAS ENTERED.

The admitted facts are that the Act dissolving Defense Supplies Corporation became effective on July 1, 1945, that judgment was rendered by the Trial Court on April 15, 1946, and that the twelve-month period within which to move for substitution expired on July 1, 1946. Even though we assume, for the purpose of argument, that the Act can be construed to discontinue the life of Defense Supplies Corporation after the expiration of the twelve-month period, there can be no doubt that its life was continued at least until July 1, 1946. The decision of this Court necessarily construes the Act to mean that Defense Supplies Corporation ceases to exist for all purposes on July 1, 1945, unless a motion for substitution is made within twelve months after that date, in which event the corporation springs to life again for the purpose of validating all acts prior to the substitution. This is a strained construction and gives no effect to the express

provision of the statute against abatement. Congress must have intended that the life of the dissolved corporation continues at least for the twelve-month period for the purpose of litigation. During that period the Trial Court in this case rendered judgment in favor of an existing corporation, and such act on the part of the Court was not a nullity. At the time of the judgment the corporation was, by the express provisions of the statute, in existence for purposes of litigation. The fact that it may have later died may affect the right to appeal, but cannot invalidate the judgment theretofore validly made. In this connection we refer to the dissenting opinion of Judge Healy (page 17 of the Court's opinion) where he states "in any view of the statute, there was no lack of a party plaintiff" and to the decision of the Eighth Circuit in *Gaynor v. Metals Reserve Company* (.....F. (2d), decided March 25, 1948).

III.

THE COURT ERRED IN DISREGARDING APPELLANTS' WAIVER OF THE ERROR.

It is admitted that the failure to substitute was not questioned by appellants at the time the judgment was taken, at the expiration of the twelve-month period, or at any time prior to the decision of this Court on the merits of the appeal. The majority of this Court, however, hold that in spite of the inaction of appellants in this regard, in spite of the fact that the appellants who are charged with knowledge of the Act of dissolution, chose to argue the appeal and submit it to this Court

on its merits, and in spite of the fact that no prejudice whatever has been shown or even claimed, the appellants, having lost the appeal on its merits, nevertheless retain the right to have the case dismissed because of the failure to substitute. In so holding, the Court relies on *United States v. Curran*, 276 U.S. 590. But in that case, like in each of the others relied upon by the Court, the issue of waiver was not even mentioned and apparently had not been raised. It may be that in the *Curran* case there were other circumstances that prevented the possibility of waiver, but we cannot determine this as the subject is not discussed.

The majority of this Court in their opinion discuss the case of *Fix v. Philadelphia Barge Company*, 290 U.S. 530, at some length. That case holds that a similar provision for substitution contained in Section 780 of 28 *United States Code*, is purely remedial, and a failure to comply therewith does not bar a later suit on the same cause of action. The case does not involve the question of the right to substitute after the expiration of the period provided for in the statute, or the question of the remedy of the defect, and those issues are not considered. We are in accord with the holding in the *Fix* case and have not contended and do not now contend that the cause of action against appellants is barred. Reconstruction Finance Corporation can file suit again, subject of course to the defense of the statute of limitations. It is hard to imagine, however, a more useless and time-wasting procedure in view of the fact that the issues have already been presented to and determined by the Trial Court and this Court.

This Court's purpose in citing the *Fix* case is apparently to lend weight to its contention that the twelve-month period provided for in the Act of dissolution is in the nature of a statute of limitations. This serves to emphasize the fact that the provision setting up a twelve-month period is not jurisdictional in the sense that the failure to comply therewith automatically deprives the court of the power to act further. The statute of limitations is a bar to the remedy and not to the right of action. Here the failure to substitute is at most, as the majority of this Court carefully point out, a bar to the remedy and not to the right of action. It has long been established that the bar of the statute of limitations can be waived.

W. P. Brown & Sons Lumber Co. v. Commissioner,
38 F.(2d) 425, 429 (C.C.A. 6), aff'd 282 U.S. 283;
Union Sugar Co. v. Hollister Estate Co., 3 Cal. (2d)
740, 744-5;
53 C. J. S. 958, et seq.

Yet the majority of this Court hold that the alleged error in the failure to substitute can not be waived. In doing so the majority not only fail to follow their own reasoning but ignore the many cases holding that such an objection, going merely to the abatement of the action, is waived if not punctually raised and the case is allowed to continue.

Trounatine, et al. v. Bauer, Ponge & Co., Inc., et al.,
144 F.(2d) 379 (C.C.A. 2);
L. Bucki & Son Lumber Co. v. Atlantic Lumber Co., 128 Fed. 332 (C.C.A. 5), certiorari denied
193 U.S. 672;

Mathison v. Payne, Director General of Railroads
 (Sup. Ct. of N. J.), 119 Atl. 771;
U. S. Ex Rel. Anthony Volpe v. S. D. Smith, 289
 U.S. 422, 77 L.Ed. 1298;
Cavers v. Sioux Oil & Ref. Co. (Tex.), 43 S.W. 2d
 578;
R. Piel Gin Co. v. Ind. Farmers' Gin Co. (Tex.),
 257 S.W. 630.

IV.

THE COURT ERRED IN RELYING ON DECISIONS INVOLVING PUBLIC OFFICIALS WHICH ARE NOT IN POINT HERE.

The majority of the Court rely upon certain decisions of the Supreme Court of the United States which they claim require the dismissal of this action. These decisions are *LeCrone v. McAdoo*, 253 U.S. 217, *Payne v. Industrial Board of Illinois*, 258 U.S. 613, and *United States v. Curran*, 276 U.S. 590. Each of these cases involves an action by or against a public official who resigned his office during the pendency of the action. These cases are not in point for the following reasons:

It has been established that actions by or against public officials are actions by or against them *personally* and the office or the government is in no sense a party (see *U. S. v. Butterworth*, 169 U.S. 600). The usual case is where a suit is brought against a public official to force him to take certain action. A judgment in such an action is directed only against the public official personally, and if he dies or resigns, his successor cannot be punished for disobedience. It was such a case that the court in the

Butterworth case had in mind. In the present case, however, the action is one by an agency or arm of the government for the use and benefit of the United States, which is the real party in interest. The two situations are not in any way comparable. The court in the *Butterworth* case points out the distinction as follows (169 U.S. 600, 603):

“In *Thompson v. United States*, 103 U.S. 480, the distinction is pointed out between proceedings where the obligation sought be enforced devolves upon a corporation or continuing body, and those where the duty is personal with the officer. In the former case there is no abatement. The duty is perpetual upon the corporation; in the latter, the delinquency charged is personal, and involves no charge against the Government, against which a proceeding would not lie.”

The public official cases do not involve the substitution of a successor in interest. Here Defense Supplies Corporation has been dissolved and Reconstruction Finance Corporation, which has succeeded to its property, powers and functions, including the interest of Defense Supplies Corporation in this action, seeks to be substituted. It is comparable to the substitution of the administrator of the estate of a deceased party, or the substitution of an assignee of a cause of action for the assignor. Thus, if a public official dies and it is sought to substitute the administrator of his estate, we would have a comparable situation. But there is an entirely different situation where it is sought to substitute a successor in office of a public official, as this involves the bringing in of a party who has otherwise no interest in the action. The present case is comparable to *Fleming v. Goodwin*, 165 F.(2d) 334

(C.C.A. 8) and *United States v. Koike*, 164 F.(2d) 155 (C.C.A. 9), wherein the courts, including this Court, decided that a substitution is permissible where the United States is the real party in interest.

For the foregoing reasons it is respectfully requested that a rehearing of the motion of Reconstruction Finance Corporation to be substituted for Defense Supplies Corporation and the motion of appellants to dismiss the action be granted.

Dated: May 5, 1948.

Respectfully submitted,

THEODORE R. MEYER,
BROBECK, PHLEGER & HARRISON,
*Attorneys for Reconstruc-
tion Finance Corpora-
tion and Appellee De-
fense Supplies Corpora-
tion.*

CERTIFICATE OF COUNSEL

We hereby certify that in our judgment the foregoing petition for rehearing is well founded and is not interposed for delay.

THEODORE R. MEYER,
BROBECK, PHLEGER & HARRISON.

*Due service and receipt of a copy of the within is hereby
admitted this.....day of May, 1948.*

Attorney for Appellant

No. 11419

United States

Circuit Court of Appeals

For the Ninth Circuit.

PAUL JOHN HUNT,

Appellant,

vs.

SECURITIES AND EXCHANGE COMMIS-
SION,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington
Northern Division

FILED

DEC 12 1946

PAUL P. O'BRIEN,
CLERK

No. 11419

United States
Circuit Court of Appeals
For the Ninth Circuit.

PAUL JOHN HUNT,

Appellant,

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

PAGE

Appeal:

Certificate of Clerk (DC) to Transcript of Record on	39
Notice of, to CCA	32 60
Statement of Points Upon Which Appel- lant Intends to Rely on	64
Application for Order to Show Cause	3
Certificate of Clerk (DC) to Transcript of Record on Appeal	39
Complaint	35
Court's Oral Decision	21
Decree of Permanent Injunction	6
Docket Entries	61
Names and Addresses of Attorneys	1
Notice of Appeal to the United States Circuit Court of Appeals, Ninth Circuit	32 60
Order and Judgment	30
Order, to Prosecute the Respondent, Paul John Hunt	2

Order to Show Cause	17
Statement of Points Upon Which Appellant Intends to Rely on Appeal	64
Witnesses:	
Hunt, Paul John	
—direct	41 52
—cross	43 56

NAMES AND ADDRESSES OF ATTORNEYS

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608 Fourth & Cheery Bldg.,

Seattle 4, Wash.

Attorney for Appellee:

JAMES E. NEWTON, ESQ.,

810, 1411 Fourth Avenue Bldg.,

Seattle 1, Wash. [1*]

In the United States District Court for the Western
District of Washington, Northern Division

No. 1560

In the Matter of:

PAUL JOHN HUNT.

ORDER

This matter having come on for hearing, and it appearing to the Court from the application of the Securities and Exchange Commission, verified by James E. Newton, and affidavit of W. Forbes Webber, filed herein, that the decree of this Court entered February 18, 1946, in the matter of Securities and Exchange Commission, Plaintiff, vs. Paul John Hunt, Defendant, Civil Action, File No. 1480, may have been defied and set at naught,

It Is Therefore Ordered, Adjudged, and Decreed: That James E. Newton be and he is hereby directed to prosecute the respondent, Paul John Hunt, on behalf of this Court; and it is further directed that a copy of this order is to be served on the respondent, together with a copy of the application and affidavit of W. Forbes Webber and exhibits thereto and order to show cause.

Done in open Court this 4th day of June, 1946.

LLOYD L. BLACK,

United States District Judge.

[Endorsed]: Filed June 4, 1946. [2]

[Title of District Court and Cause.]

APPLICATION FOR ORDER TO
SHOW CAUSE

1. On February 18, 1946, this Court in the cause entitled Securities and Exchange Commission, Plaintiff, vs. Paul John Hunt, Defendant, Civil Action, File No. 1480, entered a decree of permanent injunction enjoining and restraining Paul John Hunt from the commission of certain acts and practices. A copy of said decree of injunction is attached hereto, marked Exhibit A, and is incorporated and made a part of this application.

2. The defendant, Paul John Hunt, had actual knowledge of the contents of said decree and of all the proceedings in said cause No. 1480, heretofore referred to, and consented to the entry of said decree of injunction therein.

3. The defendant, since February 18, 1946, has engaged in the sale of the same securities arising out of and in connection with the sale of assignments of oil and gas leases on land located in Yakima and Benton counties, Washington, as described in and the subject of the complaint and the decree of injunction herein, continuously and without interruption and up to the time of the filing of this application, through the use of the mails. [3] The defendant has likewise caused to be carried through the United States mails such securities for the purpose of sale and for delivery after sale.

4. There never has been and there is no regis-

tration statement as to said securities on file with the Securities and Exchange Commission nor in effect; and the sale of said securities is not exempt from the provisions of the Securities Act by its terms or the rules and regulations of the Securities and Exchange Commission promulgated thereunder.

5. The conduct of the defendant, as aforesaid, has been a wilful and disobedient defiance of the decree of injunction of this Court entered February 18, 1946.

Wherefore, the plaintiff prays that an order to show cause issue requiring Paul John Hunt to show cause, if any he may have, on the 11th day of June, 1946, at 10:30 o'clock a.m., in the court room in the United States Court House in Seattle, Washington, why he should not be held in criminal contempt of the order of the Court dated February 18, 1946, and punished therefor, on account of his conduct subsequent to that date, and upon a return [4] of such order it be made absolute and the defend-

ant, Paul John Hunt, be adjudged in criminal contempt of court and punished therefor.

/s/ EDWARD H. CASHION,
Counsel.

/s/ DAY KARR,
Attorney.

/s/ JAMES E. NEWTON,
Attorney.

/s/ W. FORBES WEBBER,
Attorney.

SECURITIES & EXCHANGE
COMMISSION,

810 1411 Fourth Avenue
Building, Seattle 1, Wash-
ington. [5]

State of Washington,
County of King—ss.

James E. Newton, being first duly sworn, deposes and says:

He is an attorney for the Securities and Exchange Commission, an agency of the United States, and one of the attorneys of record in this cause; that he has read the foregoing application, knows the con-

tents thereof, and as to the matters therein he believes them to be true.

/s/ JAMES E. NEWTON.

Subscribed and sworn to before me this 27th day of May, 1946.

[Seal] /s/ DAY KARR,

Notary Public for Washington.

My commission expires Nov. 9, 1948. [6]

EXHIBIT A

In the United States District Court for the Western
District of Washington, Northern Division

Civil Action, File No. 1480

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

vs.

PAUL JOHN HUNT,

Defendant.

DECREE OF PERMANENT INJUNCTION

This cause coming on to be heard on the 18th day of Feb., 1946, on the verified complaint filed herein, and Paul John Hunt, defendant, not contesting the allegations contained therein, and upon stipulation of the parties hereto, on the motion of the

Securities and Exchange Commission, plaintiff, and the Court being fully advised in the premises,

It Is Hereby Adjudged, Ordered and Decreed that the defendant, Paul John Hunt, his agents, servants, employees, attorneys and assigns, and each of them, be enjoined from directly or indirectly:

(a) making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil or gas rights, or interests or instruments commonly known as securities, arising out of or in connection [7] with the sale of assignments of oil and gas leases on land located in Yakima or Benton counties, Washington, or any other securities, through the use or medium of any prospectus or otherwise;

(b) carrying such securities or causing them to be carried through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or for delivery after sale;

unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended.

Done in open Court this 18th day of February,
1946.

/s/ LLOYD L. BLACK,

United States District Judge.

Presented by:

/s/ JAMES E. NEWTON,

Attorney for Plaintiff.

The undersigned defendant, Paul John Hunt, having read and considered the provisions of the foregoing judgment, and admitting the jurisdiction of the Court over him and the subject matter of this action, and admitting the allegations contained in the complaint on file in this cause, consents to the entry of this judgment.

/s/ PAUL JOHN HUNT.

O.K. as to form:

/s/ LEWIE WILLIAMS,

Attorney for Defendant.

[Endorsed]: Filed June 4, 1946. [8]

In the United States District Court for the Western
District of Washington, Northern Division

No. 1560

In the Matter of:

PAUL JOHN HUNT.

AFFIDAVIT OF W. FORBES WEBBER

State of Washington,

County of King—ss.

W. Forbes Webber, being first duly sworn, on oath deposes and says:

I am an attorney for the Securities and Exchange Commission, attached to the Seattle Regional Office.

On April 12, 1946, I personally interviewed Paul John Hunt at his office in the Arcade Building, Seattle, Washington, with regard to the sales activities engaged in by him since the entry of the decree of injunction on February 18, 1946. Mr. Hunt at that time stated to me that, on advice of his attorney, after the entry of the decree of injunction he and his sales organization had continued their activities in the sale of assignments of oil and gas leases on land located in Yakima and Benton counties, Washington, to residents of the State of Washington, using the mails in connection with such sales and for the purpose of delivering the securities after sale; and he stated to me that the securities which he had been selling were identical in every respect with those which he and his sales organization had [9] sold prior to the entry of the decree of injunction, as described in and the

subject of the complaint and the decree of injunction:

Mr. Hunt stated that these securities which had been sold since February 18, 1946, were being sold for the same purpose as the securities sold prior to February 18, 1946; that is, to raise money to finance the continuation of drilling operations and the exploitation of oil and gas in Yakima and Benton counties, Washington. Mr. Hunt stated to me at that time that the same procedure was being followed in connection with the sales made after February 18, 1946, as had been followed prior to that date; namely, when his agents made a sale a signed subscription was obtained from the purchaser setting forth the number of units purchased in the so-called "Paul John Hunt Pool" and the price paid therefor, and at the same time a receipt was given by the sales representative acknowledging receipt of the amount of money paid at the time of the subscription. He stated that in some instances, when the down payment amounted to only 20% of the total investment, this down payment was retained by the sales representative as his or her commission, and in those instances the sales representative would forward through the mails to him (Hunt) the signed subscription blank together with a carbon copy of the receipt given to the investor, for the purpose of the records kept in the Seattle office. However, if the total purchase price was paid at the time the subscription was entered into, it was then the custom for the sales representative in Spokane or Yakima to forward to him (Hunt)

through the mails the amount of the subscription less the sales representative's 20% commission. Mr. Hunt stated that upon receipt [10] in Seattle of the subscription blank and receipt a form letter was then sent through the mails to the purchaser acknowledging receipt of the down payment and reciting the balance to be paid in monthly installments. Attached hereto, marked Exhibit A, is a sample copy of such form letter, which was given to me by Mr. Hunt. Mr. Hunt stated that upon full payment of the subscription copies of the contracts evidencing the purchaser's interest in the Paul John Hunt Pool were forwarded through the mails to the purchaser.

Mr. Hunt stated to me at that time that this method of accepting and acknowledging subscriptions and delivering evidences of interests in the Pool was followed by him in connection with the sales both before and after the entry of the decree of injunction on February 18, 1946.

Mr. Hunt stated that the sales activities during the latter part of February and March were disappointingly small because of the status of the development on the Snipe's Mountain No. 1 well then being drilled, which operations had been halted due to damage to the drilling rig.

Mr. Hunt arranged for his bookkeeper, Miss Alice Anderson, to make available to me information from his sales ledger and index cards reflecting sales and deliveries after sale since February 18, 1946; and my examination of the ledger and index cards disclosed the following information

with respect to sales and deliveries after sale by Paul John Hunt since February 18, 1946: [11]

Purchaser	Amount of Purchase	Date of Sale	Date of Delivery
-----------	--------------------	--------------	------------------

Jennie H.

McCray	\$100 for 4 units	2-23-46	
--------	-------------------	---------	--

1404 Bolystone Ave.,

Seattle, Wash.

(New Member.)

Guy E.

Powell	\$ 50 for 2 units	3- 8-46	3-11-46
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Rt. 4, Box 666,

Renton, Wash.

(N. S. Navy.)

(New Member.)

George H.

Walters	\$500 for 20 units		2-23-46
---------	--------------------	--	---------

910½ W. 2nd Ave.,

Spokane, Wash.

(New Member.)

Dean and Dorris

Donaldson	\$ 50 for 2 units		2-23-46
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824 25th,

Spokane, Wash.

(New Member.)

Delia and Jesse

Wallace	\$100 for 4 units	3-28-46	
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Okanogan, Wash.

(New Member.)

Under instructions from Mr. Hunt, Miss Anderson also furnished me the attached copies of letters of transmittal used in connection with certain of the above described sales.

Mr. Hunt stated to me at that time that the securities in the form of interests in assignments of oil and gas leases on land located in Yakima and Benton Counties, Washington, which he was then selling were all part of the same offering which was commenced by him in January, 1940, for the purpose of financing the development of gas and oil in Yakima and Benton counties, [12] where the leases were located, and that it was his intention to continue the sale of these same interests.

/s/ W. FORBES WEBBER.

Subscribed and sworn to before me this 24th day of May, 1946.

[Seal] /s/ PAYNE KARR,

Notary Public for Washington.

My commission expires May 7, 1948. [13]

EXHIBIT A

PAUL JOHN HUNT

Not Incorporated

Sole Developer Rattlesnake Hills

Oil and Gas Leases

5147 Arcade Building — Seattle, Washington

Eliot 8189

505 Radio Central Building

Spokane, Washington — Riv. 8362

We acknowledge with thanks your subscription for acres of oil and gas leases in our Rattlesnake Hills Project, on which you made a down payment of \$. and agree to pay the balance in monthly installments of \$. each.

When you have completed payments on subscription, we will send you copies of contracts showing land description.

We appreciate very much your cooperation with our efforts to develop the large quantities of oil and gas that we all believe will be found on our leasehold in Benton and Yakima counties of this state. You can further help this good cause by calling the project to the attention of your relatives and friends.

Yours very truly,

PAUL JOHN HUNT.

PJH:b

February 23, 1946

Mr. George H. Walters,
910½ W. 2nd Avenue,
Spokane, Washington.

Dear Mr. Walters:

Enclosed you will find copies of contracts showing land descriptions on twenty-five acres of oil and gas leases in our Rattlesnake Hills Pool. These leases are in exchange for 5000 shares Juneau Mines stock.

We sincerely trust this exchange will prove highly profitable both in your mine and our oil and gas development program.

Thanking you for your cooperation, we are,

Yours very truly,

PAUL JOHN HUNT.

PJH:@

Enc. [15]

February 23, 1946

Dean and Dorothy Donaldson,
W. 824 25th,
Spokane, Washington.

Dear Leaseholders:

We are in receipt of full payment on your subscription for two and one-half acres of oil and gas leases in our Rattlesnake Hills Pool and you will find enclosed copies of contracts showing land descriptions.

We appreciate your cooperation with our efforts to develop a commercial supply of oil and natural

gas on our leasehold in Benton and Yakima Counties, Washington.

Please feel free to call at our Seattle office whenever you may be in this vicinity.

Yours Very truly,

PAUL JOHN HUNT.

PJH:@

Enc. [16]

March 11, 1946

Mr. G. E. Powell,
Rt. 4, Box 666,
Renton, Washington.

Dear Mr. Powell:

We are in receipt of full payment on your subscription for an additional two and one-half acres of oil and gas leases in our Rattlesnake Hills Pool and you will find enclosed copies of contracts showing land descriptions. This makes your total holdings in our pool five acres.

We appreciate your cooperation in our endeavor to obtain a commercial supply of oil and gas on our leasehold in Benton and Yakima Counties, Washington.

Yours very truly,

PAUL JOHN HUNT.

PJH:@

Enc.

[Endorsed]: Filed June 4, 1946. [6-a]

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

This matter having come on for hearing, and it appearing to the Court on examination of the application for order to show cause and affidavit of W. Forbes Webber, filed herein, that a reasonable cause exists for believing Paul John Hunt has defied and set at naught the decree of injunction of this Court entered herein February 18, 1946, in that cause entitled Securities and Exchange Commission, Plaintiff, vs. Paul John Hunt, Defendant, Civil Action, File No. 1480, and is guilty of criminal contempt as indicated in the verified application attached hereto:

Now, Therefore, It Is Ordered, Adjudged and Decreed: That Paul John Hunt be and appear before this Court in the court room in the United States Court House in Seattle, Washington, on the 11th day of June, 1946, at 10:30 o'clock a.m., then and there to show cause, if any he may have, why he should not be held in criminal contempt for violation of the decree of injunction of this Court entered February 18, 1946, [17] and punished therefor, as prayed for in the application of the Securities and Exchange Commission attached hereto.

Done in open Court this 4th day of June, 1946.

LLOYD L. BLACK,

United States District Judge.

Presented by:

/s/ JAMES E. NEWTON,

Attorney.

[Endorsed]: Filed June 4, 1946. [18]

[Title of District Court and Cause.]

STIPULATION

It Is Hereby Stipulated and Agreed by the undersigned that the facts herein set forth may be considered by the Court at the hearing in the above entitled matter, and that this stipulation may be put in evidence.

That since on or about January 1, 1940, Paul John Hunt has been and is now selling securities, within the meaning of Section 2(1) of the Securities Act of 1933, as amended, namely, investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil and gas rights, and interests in instruments commonly known as securities, arising out of and in connection with the sale of assignments of oil and gas leases on land located in Yakima and Benton counties, Washington, and in the sale of such securities has been and is now using the mails, and has been and is now directly and indirectly carrying such securities and causing

them to be carried through the mails for the purpose of sale and delivery after sale.

That since the commencement of such sales in January, 1940, and continuing up to the date hereof, the said securities sold by Paul John Hunt have all been part of the same offering or issue, being sold for the same single purpose, namely, to finance the exploitation of oil and gas in the areas in which such leaseholds are located. That although the prices at which such securities have been offered to the public have ranged from \$16.00 to \$25.00 per unit of $1\frac{1}{4}$ acres, the persons so purchasing all obtain equal rights under the pool arrangement in which they become members by their purchase, dependent only upon the amount of acreage held, irrespective of the price paid, the offering made in January, 1940, and continuing to the date hereof being a single, continuous offering [19] for one and the same purpose, namely, financing from the proceeds thereof the exploitation of oil and gas in Yakima and Benton counties; that it is intended by Paul John Hunt to continue the sale of said issue of securities until all the acreage has been sold or sufficient has been sold to the public to fully finance said purposed exploitation.

That the sales of such securities have included a few sales to residents of Idaho and California, and in the sale of such securities the mails were used by Paul John Hunt and such securities were sent and caused to be sent through the mails for the purpose of sale and delivery after sale. Since

the decree of injunction against Paul John Hunt entered by this Court on February 18, 1946, however, the sale of such securities has been restricted exclusively to persons resident in the State of Washington.

That since the entry of said decree of injunction Paul John Hunt has been and is now continuing the sale of securities which are identical in every respect to those sold prior thereto. That the securities now being sold are a part of the same offering, issue, general plan of financing, and for the same purpose as those securities sold prior to said decree to the residents of Washington, Idaho, and California, the sale of which securities said decree restrained and enjoined. That the mails have been and are now being used in the sale and delivery after sale of such securities by Paul John Hunt.

That Paul John Hunt and his agents and sales representatives at all times herein mentioned have been and are now residents of and doing business in the State of Washington.

That no registration statement with respect to such securities is now or ever has been in effect with the Securities and Exchange Commission. [20]

That the affidavit of W. Forbes Webber on file herein truly reflects and sets out the manner and method of selling said securities both before and after the entry of said decree, and the contents of said affidavit and the exhibits attached thereto are incorporated and made a part of this stipulation as fully as if set out herein. That Paul John Hunt

had actual knowledge of the contents of said decree of injunction and of all the proceedings in said cause, Civil Action No. 1480, heretofore referred to.

Dated at Seattle, Washington, this 3rd day of June, 1946.

SECURITIES & EXCHANGE
COMMISSION,

By /s/ JAMES E. NEWTON,
Attorney.

/s/ PAUL JOHN HUNT.

/s/ LEWIE WILLIAMS and

/s/ FRED'K R. BURCH,

Attorneys for Paul John
Hunt.

[Endorsed]: Filed June 11, 1946. [21]

[Title of District Court and Cause.]

COURT'S ORAL DECISION.

Black, J.

When this matter was presented to me on the 11th of June I felt that under the evidence and the stipulations and the law as given to me that John Paul Hunt was in contempt. He agreed voluntarily to abstain from pursuing the same course of action until my decision, and advised me that he was not anxious to hurry me. Therefore, I felt that no one could be hurt if I took sufficient time to satisfy me that my impression was correct, or convince me that I was mistaken.

I am still of the opinion that my impression on June 11th was right and in accord with the facts and the law.

The statute is clear as I read it. In the absence of my files, I may say this to the parties, that it is not necessary that the mails be used between states. Congress has jurisdiction of the mails; Congress had the right to say that the mails should not be used; Congress had the right to say that the mails should not be used between Seattle and Spokane as well as between Spokane and Coeur d'Alene. Between Spokane and Coeur d'Alene, of course, the Washington-Idaho boundary intervenes. The statute is definite that the mails are not to be used except under certain special circumstances. One of the special circumstances was that the entire issue was sold in one state by a seller in that state to persons residing in that state. The exemption was not for an issue which was largely within the state.

The complaint in cause No. 1480, which was filed [22] February 18, 1946, alleged that "Since on or about January 1, 1940, defendant has been and now is selling securities * * * and in the sale of such securities has been and is now directly and indirectly using the mails and the means and instruments of transportation and communication in interstate commerce, and has been and is now directly and indirectly carrying such securities and causing them to be carried through the mails and in interstate commerce, by means and instruments of transportation, for the purpose of sale and delivery after sale;" and that "The defendant will, unless en-

joined, continue to engage in the acts and practices set forth in this complaint.”

On the 18th of February, 1946, the defendant Paul John Hunt came personally into court and signed this statement in writing:

“The undersigned defendant, Paul John Hunt, having read and considered the provisions of the foregoing judgment, and admitting the jurisdiction of the Court over him and the subject matter of this action, and admitting the allegations contained in the complaint on file in this cause, consents to the entry of this judgment.”

I asked him under oath, “Are you familiar with all the contents of the complaint upon which that decree is based?” His answer was, “Yes, sir.”

In the stipulation presented to me, which stipulation is signed by Paul John Hunt as well as by his counsel, it is stated, “that the sales of such securities have included a few sales to residents of Idaho and California, and in the sale of such securities the mails were used by Paul John Hunt, and such securities were sent and caused to be sent through the mails for the purpose of sale and delivery after sale.”

The prosecution of this contempt proceeding depended and had a right to depend upon such stipulation, and depended [23] and had a right to depend upon the judgment in the original action No. 1480 and upon the statement of Mr. Hunt that he had read the complaint.

It is true that on the 11th of June Mr. Hunt was sworn as a witness and to a considerable degree

contradicted the allegations of the complaint and contradicted the statements of his own stipulation.

There was some cross examination which indicated at least that the government would have been able to produce testimony of more outside state sales than he stated. But even if Mr. Hunt's statement under oath on the 11th was correct and if his stipulation and the original judgment are wrong,—even then it seems to me that he removed himself from the exemption because he concedes that the issue was not sold entirely within the state to those resident within the state.

I am sorry that my own files are not present so that I might have the law before me as well as the opinion of counsel for the Commission, rendered about 1937 according to my memory. As I remember the statute, it authorizes a prosecution criminally for a violation, and authorizes a sentence of not more than five years in the penitentiary, or, a fine of five thousand dollars, or both. (Mr. Newton nods concurrence.)

I can be mistaken; Mr. Newton says I am correct in my recollection. In any event the Congress did authorize a very substantial penalty.

Mr. Hunt came into Court on the 11th and conceded that in face of the decree of February 18, he had knowingly and intentionally used the mails many times, although, of course, the mails, according to his testimony were used to persons in the state of Washington.

It is clear that Mr. Hunt was advised by his counsel [24] that he had the right to use the mails

providing the mails were used as intrastate mails. I am sure that his counsel were mistaken. The statute prohibits use of interstate commerce or of the mails. There is nothing in the statute which says that interstate mails are taboo; the statute says the mails shall not be used. I do not know how a person can write a letter at Spokane for Seattle and have such letter carried by the postal authorities without having employed the mails.

I have been disturbed as to the penalty. Unquestionably, Paul John Hunt thought he had the right to do as he did. However, the advice of counsel is never a defense. Every man is presumed to know the law. That means that if no one could be held accountable except it were demonstrated he knew he was mistaken, there would be no practical enforcement. I had a man in McNeills Island once, who wished to get out, seriously contend to me that since he did not know that it was against federal law to rob a state bank which was insured federally, that I should release him. He was a lawyer; he followed his own legal advice. He thought that he could rob a state bank and be amenable only to state prosecution. He was convicted and sentenced. He did not like McNeills Island, and appealed to me. I made him stay. The Circuit Court of Appeals said I was correct. Now, he sought legal advice. Both he and his lawyer, because they were the same individual, thought that the federal law did not apply.

In this instance, of course, Mr. Paul John Hunt sought someone other than himself to advise him; but if the mistake of the lawyer would be a defense,

then a man would always seek that attorney who was apt to make a mistake.

The law is effective. Paul John Hunt is in contempt of court in having violated the provisions of the decree of February 18 in cause No. 1480. However, I am satisfied that in [25] imposing the sentence the Court should consider his good faith and the good faith of his counsel. I should consider one thing further. I think the decree could have been a bit plainer than it was, that is the decree of February 18, 1946.

It seems to me that a fine of Four Hundred Dollars is not inappropriate, and I would say a fine of four hundred dollars without costs.

Do you have any substantial objection, Mr. Newton?

Mr. Newton: No objection.

The Court: Counsel? (Addressing Mr. Burch.)

Mr. Burch: I would like to ask, if your Honor please, just exactly what this fine would signify. Now, in the first place, Mr. Hunt was dealing with intrastate business by permission of the State. Inadvertently, there was a sale made outside of the state. I say "inadvertently" because I base my conclusion upon the fact that never once has Mr. Hunt ever solicited any business outside of the state that I know of. He has no agents——

The Court: (Interposing): Well, counsel, as I say, here was a complaint which came before me on February 18,, and in it was alleged that since on or about January 1, 1940, the defendant has been and now is selling securities and in the sale of such

securities has been and is now directly and indirectly using the mails and the means and instruments of transportation and communication in interstate commerce.”

Mr. Burch: If your Honor please——

The Court: So that was presented to me——

Mr. Burch: ——I simply referred to that so that I might ask the question.

The Court: All right.

Mr. Burch: Now inasmuch as the Court—there was, and properly so, an injunction issued. The injunction was that [26] we must not repeat it. Now, he has never repeated any interstate business, but he cannot do intrastate business unless he can use the mails.

Now, if he is fined four hundred dollars, does that mean that he still cannot use the mails?

The Court: Certainly; if he uses the mails, then he will be guilty of contempt again.

Mr. Burch: He will be guilty again? So that the business which he has built up for years, by an inadvertent sale unsolicited, is destroyed, and his investors—and they are numerous—will stand to lose their entire investment, because we cannot conduct business without using the mails. It is quite serious.

The Court: Well, counsel, just a minute. This decree which he signed, and which his counsel O.K.’d as to form, enjoined the defendant from directly or indirectly (a) making use of any means or instruments of transportation or communication in interstate commerce or of the mails. It did not say inter-

state mails. And he was also enjoined (b) from carrying such securities or causing them to be carried through the mails or in interstate commerce. Now, if Mr. Hunt is anxious to protect the interest of his clients, he can comply with the statute. He can register as required.

Mr. Burch: In interstate commerce to do intrastate business,—it is sort of a conundrum.

The Court: No, it is not a conundrum. The law says he shall not use mails at all to sell securities except in some special circumstance he can sell and issue entirely and completely in intrastate activity; not interstate but intrastate. There is no conundrum about it. The law is that he is not to use the mails at all. [27]

Now, you wish me to repeal the law.

Mr. Burch: We will accept your Honor's judgment in the matter.

The Court: He can register if he is entitled to registration.

Mr. Burch: That is another problem.

The Court: Well, that is his problem. It was suggested by the attorney for the Commission that since these sales of some two thousand dollars or more were made in violation of the decree, that I should set them aside. I stated that I felt attempting to unscramble what had cooked since February 18 was too great a task and that I would not do that. If these people bought from Mr. Hunt knowing that he was not registered, they ran the risks. If he represented to them that he was registered, of course, they have their remedy against him.

I am assuming that the buyers were not depending upon the Securities and Exchange Commission.

I have eliminated the costs by virtue of the good faith of Mr. Hunt and the good faith of his counsel. If he had not been in good faith, the court would have been asking as to an appropriate place for his custody.

I may let him know that a violation of the decree is serious, and therefore, if he should repeat it, I would not be able to say he was again in good faith.

The appropriate order may be presented after service.

Mr. Newton: Any particular time to present it?

The Court: I don't care. Mr. Hunt will understand that either before or after entry of the order the decree of February 18 is in effect. Therefore, he cannot afford to use the mails in connection with this issue. He cannot use any method of interstate commerce or communication, mails or otherwise. [28] In intrastate communication he cannot use the mails, nor can he use the mails interstate. He cannot use the mails between Bellingham and Seattle. He cannot use the mails or other methods of transportation or communication between Seattle and Portland, Oregon, for instance.

How would next Monday be at 11:00 o'clock?

Mr. Newton: Very well.

The Court: Satisfactory, Mr. Burch?

Mr. Burch: Yes.

CERTIFICATE

I, James R. Royse, do hereby certify that I am official court reporter for the above-entitled Court, and as such was in attendance upon the hearing of the foregoing matter.

I further certify that the above transcrip is a true and correct record of the matters as therein set forth.

JAMES R. ROYSE,
Official Court Reporter.

[Endorsed]: Filed Aug. 6, 1946. [29]

In the United States District Court for the Western
District of Washington, Northern Division

No. 1560

In the Matter of:

PAUL JOHN HUNT

ORDER AND JUDGMENT

This matter having come on before this Court for hearing the 11th day of June, 1946, on application of the Securities and Exchange Commission, and James E. Newton having been appointed and directed to prosecute the defendant Paul John Hunt on behalf of this Court, and it appearing to the Court from the stipulation on file in the matter and the evidence adduced at that time that Paul John Hunt did violate the decree of permanent injunc-

tion entered by this Court on February 18, 1946, in the matter of Securities and Exchange Commission, Plaintiff, vs. Paul John Hunt, Defendant, Civil Action File No. 1480, as set forth in the application of Securities and Exchange Commission, the defendant Paul John Hunt with actual knowledge of the contents of said decree of injunction and of all the proceedings in said cause, Civil Action No. 1480, having since the entry of said decree of injunction on February 18, 1946, sold securities in the State of Washington and to residents of said state only, which securities are identical in every respect and part of the same issue, offering, general plan of financing and for the same purpose as those securities sold prior to said decree to the residents of Washington, Idaho, and California, the sale of which securities said decree restrained and enjoined, and the mails having been used in the sale and delivery after sale of such securities by the [30] defendant Paul John Hunt since the entry of said decree on February 18, 1946, no registration statement being in effect with the Securities and Exchange Commission and no exemption from the provisions of Section 5 of the Securities Act of 1933, as amended, being available with respect to such securities,

It Is Hereby Ordered, Adjudged, and Decreed that Paul John Hunt be and he is hereby held in contempt of this Court for violation of the decree of permanent injunction entered against him on February 18, 1946, in the matter of Securities and Exchange Commission vs. Paul John Hunt, as

charged in the application of Securities and Exchange Commission on file herein; and,

It Is Further Ordered that the contemnor Hunt pay a fine to the United States of America in the sum of \$400.00 without costs and shall stand committed until said fine is paid.

Done in open Court this 12th day of August, 1946.

LLOYD L. BLACK,

United States District Judge.

Presented by:

JAMES E. NEWTON

Attorney appointed by Court.

Approved as to form:

LEWIE WILLIAMS and

FRED'K R. BURCH.

Attorneys for Paul John
Hunt.

[Endorsed]: Filed Aug. 12, 1946. [31]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE UNITED
STATES CIRCUIT COURT OF APPEALS,
NINTH CIRCUIT

Please take notice that the defendant, Paul John Hunt, whose address is 5103 Arcade Building, Seattle, Washington, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the order made and entered in the above-

entitled action and filed in the office of the Clerk of the District Court of the United States for the Western District of Washington, Northern Division, on the 12th day of August, 1946, adjudging appellant guilty of contempt of Court on the charge of violating an injunctive order previously entered on February 18, 1946, under Civil Action file No. 1480, in the said District Court, and ordering appellant to pay a fine of Four Hundred Dollars.

Dated at Seattle this 21st day of August, 1946.

LEWIE WILLIAMS
FRED'K R. BURCH

Attorneys for Appellant.

[Endorsed]: Filed Aug. 21, 1946. [32]

[Title of District Court and Cause.]

PRAECIPE

To the Clerk of the Above-entitled Court:

You will please prepare the record on appeal in the above-entitled cause, said record to contain the following designated instruments:

1. Order Appointing Attorney.
2. Decree of Permanent Injunction.
3. Application for Order to Show Cause.
4. Order to Show Cause.
5. Stipulation as to Facts.

6. Webber's Affidavit and Attached Exhibits.
7. Hunt's Testimony at the Hearing.
8. Court's Oral Decision.
9. Order and Judgment.
10. Notice of Appeal.

LEWIE WILLIAMS

FRED'K R. BURCH

Attorneys for Appellant.

Due service of the foregoing Praecipe acknowledged this 9 day of September, 1946.

JAMES E. NEWTON

Attorney for Court.

[Endorsed]: Filed Sept. 9, 1946. [33]

[Title of District Court and Cause.]

ORDER

It appearing to the Court that pursuant to his notice of appeal in the above entitled action filed under date of August 21, 1946, the appellant has served upon appellee and filed with the above entitled Court a designation of the portions of the record, proceedings, and evidence to be contained in the record on appeal, which designation fails to include the complaint filed in Civil Action File No. 1480 in the above entitled Court on February 18, 1946, and upon which complaint the decree of permanent injunction included in appellant's designation is based,

It Is Hereby Ordered that the Clerk of the above entitled Court be and he is hereby directed to include as part of the record on appeal in the above entitled matter the complaint filed in Civil Action File No. 1480.

Done in open Court this 12th day of September, 1946.

LLOYD L. BLACK

United States District Judge.

Presented by:

JAMES E. NEWTON

Attorney appointed by Court.

[Endorsed]: Filed Sept. 12, 1946. [34]

In the United States District Court for the Western
District of Washington, Northern Division

Civil Action, Filed No. 1480.

SECURITIES AND EXCHANGE COMMIS-
SION,

Plaintiff,

vs.

PAUL JOHN HUNT,

Defendant.

COMPLAINT

1. It appears to the plaintiff that the defendant, Paul John Hunt, is engaged and about to engage in acts and practices which constitute and will constitute violations of Section 5(a)(1) and 5(a)(2) of

the Securities Act of 1933, 15 U.S.C. 77e (a)(1) and 77e(a)(2); and the plaintiff, pursuant to Section 20(b) of the Act, 15 U.S.C. 77t(b), brings this action to enjoin such acts and practices.

2. This action arises under Section 22 (a) of the Securities Act of 1933, 15 U.S.C. 77v(a), as hereinafter more fully appears.

3. Since on or about January 1, 1940, the defendant has been and is now selling securities, namely, investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil and gas rights, and interests and instruments commonly known as securities, arising out of and in connection with the sale of assignments of [35] oil and gas leases on land located in Yakima and Benton counties, Washington, and in the sale of such securities has been and is now directly and indirectly using the mails and the means and instruments of transportation and communication in interstate commerce, and has been and is now directly and indirectly carrying such securities and causing them to be carried through the mails and in interstate commerce, by means and instruments of transportation, for the purpose of sale and delivery after sale.

4. No registration statement with respect to such securities is in effect with the Securities and Exchange Commission.

5. The defendant will, unless enjoined, continue to engage in the acts and practices set forth in this complaint.

Wherefore, the plaintiff demands a preliminary and a final injunction enjoining the defendant, Paul John Hunt, his agents, servants, employees, attorneys and assigns, and each of them, from directly or indirectly:

(a) making use of any means of instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil or gas rights, or interests or instruments commonly known as securities, arising out of or in connection with the sale of assignments of oil and gas leases on land located in Yakima or Benton counties, Washington, [36] or any other securities, through the use or medium of any prospectus or otherwise.

(b) carrying such securities or causing them to be carried through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or for delivery after sale; unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; provided that the foregoing shall not apply to any security or transac-

tion which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended.

/s/ EDWARD H. CASHION
Counsel.

/s/ DAY KARR
Regional Administrator.

/s/ JAMES E. NEWTON
Attorney.

/s/ W. FORBES WEBBER
Attorney. [37]

State of Washington,
County of King—ss.

James E. Newton, being duly sworn, deposes and says that he is an attorney for the Securities and Exchange Commission, plaintiff herein, that he has read the foregoing complaint, that he knows the contents thereof; and that to the best of his knowledge and belief there is good ground to support the allegations therein.

JAMES E. NEWTON

Subscribed and sworn to before me this 18 day of February, 1946.

[Seal] DAY KARR
Notary Public for Washington. My commission expires: Nov. 9, 1948.

[Endorsed]: Filed Feb. 18, 1946. [38]

In the United States District Court for the Western
District of Washington, Northern Division

No. 1560

In the Matter of:

PAUL JOHN HUNT

CERTIFICATE OF CLERK OF U. S. DIS-
TRICT COURT TO TRANSCRIPT OF
RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that the foregoing type-written transcript of record, consisting of pages numbered from 1 to 38, inclusive, is a full, true and complete copy of so much of the record, papers and other proceedings in the above entitled cause as is required by designation of counsel filed and shown herein, together with the complaint filed in civil action No. 1480, included herein under direction of the Court, as the same remain of record and on file in the office of the Clerk of said District Court at Seattle, and that the foregoing together with the reporter's transcript of testimony and proceedings transmitted as a part hereof, constitute the record on appeal herein from the order and judgment dated August 12, 1946, of said United States District Court for the Western District of Washington to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the foregoing is a true and correct statement of all expenses, costs, fees and charges incurred in my office by or on behalf of the appellant for making record, certificate or return to the United States Circuit Court of Appeals for the Ninth Circuit, to-wit; [39]

Clerk's fees for making record, certificate or return:

7 pages at 40c	\$ 2.80
32 pages at 10c	\$ 3.20
(Copies furnished)	
Appeal Fee	\$ 5.00
Total	\$11.00

I hereby certify that the above amount has been paid to me by the attorneys for the appellant.

In Witness Whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle, in said District, this 14th day of September, 1946.

MILLARD P. THOMAS

Clerk.

[Seal] /s/ TRUMAN EGGER

Chief Deputy Clerk. [40]

In the United States District Court for the Western
District of Washington, Northern Division.

No. 1560

In the Matter of

PAUL JOHN HUNT.

June 11, 1946.

PAUL JOHN HUNT

being first duly sworn, testified in his own behalf
as follows:

Direct Examination

By Mr. Burch:

Q. State your name.

A. Paul John Hunt.

Q. And you are the Paul John Hunt who is
to answer and show cause, if any you have, on a
charge of contempt [1*] of court? A. Yes.

Q. How long have you been doing business in
the State of Washington?

A. Since October, 1939.

Q. Now from whom did you derive the authority
to sell your securities in the state of Washington?

A. State Department of Licenses.

Q. Did you secure it at that time?

A. I did.

Q. And is it in force and effect today?

A. Yes, sir.

Q. And any sale that you made in the state of

* Page numbering appearing at foot of page of original Reporter's Transcript.

(Testimony of Paul John Hunt.)

Washington to a citizen of the state of Washington is under the permission of the Director of Licenses of the state of Washington, is that true?

A. That is right.

Q. Now, did you ever at any time have an agency soliciting the sale of securities in interstate commerce? A. No, sir.

Q. What have your sales been confined to outside of the two sales—I believe it was one in Nevada and one made in California,—to what have your sales been confined?

A. The state of Washington. [2]

Q. Did you ever apply to the Federal Securities & Exchange Commission for permission to sell in interstate commerce? A. No, sir.

Q. You never applied for permission to sell in interstate commerce as I understand you?

A. No, sir.

Mr. Burch: That is all.

Mr. Newton:: Will you mark this for identification, please?

(Four documents marked Petitioner's Exhibits 1, 2, 3 and 4, for identification.)

Q. (By Mr. Burch) Since this order of injunction was served upon you, have you made any sales to anyone outside of to citizens of the state of Washington and in the state of Washington by virtue of your authority so to do from the Director of Licenses of the state of Washington?

The Court: On the court's own motion I am

(Testimony of Paul John Hunt.)

going to strike that question. I am confused by it. The answer, therefore, will not help me. I think there are a number of questions embraced in one; so that the question is stricken.

Mr. Burch: Well, I don't believe it is germane.

The Court: I am not holding it is not germane. It may be offered. It may not be germane, but the question [3] was long and involved and leading. I would not know what to do with the answer. If it is important, I would suggest that you break it up into short questions.

Q. (By Mr. Burch) I will ask you this question, since service of the injunction upon you to cease sending your securities through the mail, have you made any sales to anybody but a citizen of the state of Washington?

A. No, sir.

Mr. Burch; That is all. That is admitted in the stipulation, that last question.

Cross Examination

By Mr. Newton:

Q. Mr. Hunt, you stated on direct examination that you have maintained no agencies for the solicitation and sale of securities in interstate commerce? A. That is right.

Q. Now, what do you mean by agencies? Do you mean a person maintained outside of the state, or what do you mean by the word "agency"?

A. I means sales people.

(Testimony of Paul John Hunt.)

Q. You do not maintain any salesmen outside of the state of Washington to sell securities to persons who are not resident in the state of Washington. Is that what you mean? [4]

A. That is what I mean.

Q. Did you mean to include more than that or anything else? A. No.

Q. You did not mean, I take it, that you did not use the mails for sales to persons who are not residents in the state of Washington?

A. I admitted that in the stipulation.

Q. That is right. So that there is no confusion, the use of the mails was not included in your meaning of the word "agency."

A. That is right.

Q. You mean you had no personal agents?

A. That is right.

Mr. Burch: Now, this applies to the case before the injunction was issued.

Mr. Newton: That is correct. That is my understanding. That is what your question was directed to, not to activities before the injunction. I don't want any confusion as to what he meant by "agencies."

Q. (By Mr. Newton) Now, you are not in any way desiring to draw back from the stipulation as to the use of the mails? A. No.

Q. And that there were sales made to at least some persons [5] who are not residents of the state of Washington? A. Yes, that is so stipulated.

Q. That is correct?

(Testimony of Paul John Hunt.)

Mr. Burch: Again I repeat that is before the injunction.

Mr. Newton: That is right.

Mr. Burch: Not after.

Q. (By Mr Newton) Now, after the injunction was entered on February 18, 1946, restraining you from further sales of securities through use of the mails or means of interstate commerce unless and until registration was in effect, I understand you did make some additional sales, is that correct?

A. In the state of Washington.

Q. To residents in the state of Washington?

A. Yes.

Q. Mr. Hunt, those sales were made through use of the mails, were they not? May I hand you what has been marked Petitioner's Exhibit——

The Court: Just a minute. Is that question answered?

Mr. Newton: No, it has not been answered, but I think if I provide the witness with the exhibit, it might make it easier for him to answer the question.

The Court: All right. [6]

Mr. Newton: I will withdraw it.

Mr. Burch: Read the question.

(Reporter reads question.)

A. I don't believe so.

Q. (By Mr. Newton) They were not?

A. No.

Q. Let me hand you Petitioner's Exhibits 2 and 3——

(Testimony of Paul John Hunt.)

Mr. Burch: If your Honor please, I think that the question should be clarified. We object to it in the form that it is asked. He asked this merely as a general question,—and that is, did you use the mail? He does not distinguish by asking did you use the mails in interstate commerce or did you use the mails in intrastate commerce. Those are two vastly different questions.

The Court: I think if the question on cross examination is not clarified enough in your opinion, you should use the rebuttal rather than delay cross examination.

Q. (By Mr. Newton) Handing you Petitioner's Exhibits 2 and 3 for identification, please state what they are.

A. Exhibit 3 is a copy of an analysis of an oil sand by Gutberlet Laboratories, Seattle, Washington.

Q. Mr. Hunt, is that a mimeographed copy of a letter many of which were sent through the mails to your lease [7] holders in connection with the solicitation of further sales since the entry of the decree on February 18, 1946?

Mr. Burch: Now, if your Honor please, I object to that question on the ground that it does not distinguish; the question is, did he use these in interstate commerce.

The Court: Objection overruled.

Mr. Burch: Did he use the mails in interstate or intrastate commerce. That is the crux of the question.

(Testimony of Paul John Hunt.)

The Court: That may be the crux, but there is no reason I should not hear this evidence. If after I have heard it nothing has been established, Mr. Hunt is not hurt. Objection overruled.

A. There was a cut made of the original letter, and this is made from the cut, and this was sent out, yes.

Q. And approximately how many of those were sent out through the mails?

A. Oh, something over a thousand.

Q. And they were sent out for the purpose of soliciting further sales?

A. In the state of Washington.

Q. To residents in the state of Washington.

A. That is right. [8]

Mr. Newton: I would like to offer what has been marked Petitioner's Exhibit 3 for identification.

The Court: Admitted.

(Petitioner's Exhibit 3 for identification received in evidence.)

Q. (By Mr. Newton) Referring now to Petitioner's Exhibit 2, Mr. Hunt, and the envelope attached thereto, was that letter sent out by your office to the addressee named on that envelope?

A. It was.

Q. And you will notice on the margin that there is apparently a legend of some kind which does not appear on Exhibit No. 3. What was the purpose of that, if you will just state?

A. The statement made on the margin was

(Testimony of Paul John Hunt.)

placed on every one sent to lease holders who had moved out of the state since they purchased leases.

Q. So this letter was sent,—the letter which is marked Petitioner's Exhibit 2, which except for the legend on the bottom and on the margin is the same as 3,—was sent to Thomas Eccleston in Wilmington, California, through the mails?

A. It was.

Q. Also to solicit sales, was it?

A. No, sir. [9]

Q. What purpose was that sent for?

A. Information.

Q. If it was for information only, why on the bottom of that did you state, "We urge you to increase your lease holdings now."? Why was that included?

A. Well, to save the making of a separate circular. If you will notice, I qualified it by placing on the margin the statement I could not accept subscriptions made out of the state.

Q. But if the addressee was a resident of the state of Washington, it was to be used as a solicitation?

A. That is right.

Q. For further sales to him?

A. That is right.

Mr. Newton: I would like to offer Petitioner's Exhibit 2.

The Court: Has 3 been offered?

Mr. Newton: I offered it and Mr. Burch stated that there was no objection.

The Court: Exhibit 3 admitted.

(Testimony of Paul John Hunt.)

Mr. Burch: Who is this man Eccleston?

The Witness: Well, he is a member of the pool of lease holders.

Mr. Burch: Did he live in the state of Washington? [10] A. Yes, sir.

Mr. Burch: And did he become a member when he was a resident of this state?

The Witness: Yes, sir.

Mr. Burch: And he went to California?

The Witness: Yes.

Mr. Burch: And he gave you this address?

The Witness: Yes, sir.

Mr. Burch: And you sent him this letter?

The Witness: Yes.

Mr. Burch: That is all.

Mr. Newton: Any objection?

Mr. Burch: No objection.

The Court: Exhibit 2 admitted.

(Petitioner's Exhibit 2 for identification received in evidence.)

Q. (By Mr. Newton) Mr. Hunt, how many sales of securities have you made since the entry of the decree on February 18, approximately?

A. Oh, I guess about a dozen.

Q. And aggregating about how much?

A. I guess about \$2,000.

Q. A dozen for about \$2,000. Probably a few more than that, aren't there? It is my recollection that you said that there were closer to fifteen or twenty. [11]

A. Well, I furnished Mr. Weber a statement the

(Testimony of Paul John Hunt.)

other day of the sales made in addition to those set out in the stipulation or in his affidavit.

(Document marked Petitioner's Exhibit 5 for identification.)

Q. (By Mr. Newton) I hand you Petitioner's Exhibit 5 for identification, and I will ask you if that is what you refer to as having been furnished,—setting out the sales made by you since the compilation of the sales as of April 12 which were included in the stipulation? A. Yes.

Q. Or Mr. Weber's affidavit?

A. Yes, I believe that is the statement I gave you.

Q. I believe you had it prepared for him, did you not? A. Yes.

Mr. Newton: I would like to offer it, if you have no objection.

Mr. Burch: We have no objection to the list of sales. This was made after service of the injunction upon you?

The Witness: Yes, sir.

Q. (By Mr. Newton) In connection with the use by you of the letter in regard to the analysis, this was some [12] of the results of that mailing, was it, Mr. Hunt? A. No.

Q. It was not?

A. Oh, to some extent it may have been, yes.

Q. And in connection with those sales, those persons who paid in full have received their contracts, have they? A. I believe so.

Q. Are those contracts sent to the purchasers

(Testimony of Paul John Hunt.)

through the mails? I think that is also reflected in the stipulation.

A. Yes, generally, that is true.

Q. That is your general method? A. Yes.

Q. And would you say that has been the method since February 18, 1946? A. Yes.

Q. And that since February 18 some contracts have been sent to purchasers through the mail?

A. In the state of Washington.

Q. To residents in the state of Washington?

A. Yes, sir, to them only.

The Court: Has Exhibit 5 been offered?

Mr. Newton: I would like to offer it in evidence if I did not.

The Court: Any objection? [13]

Mr. Burch: No objection.

The Court: Exhibit 5 admitted.

(Petitioner's Exhibit 5 for identification was received in evidence.)

Mr. Newton: That is all we have.

Mr. Burch: That is all.

(Witness excused.)

The Court: That is the case except argument?

Mr. Newton: Yes.

The Court: Do you have anything further, Mr. Burch?

Mr. Burch: No.

The Court: The record will show each side rests. Is that right?

Mr. Newton: Petitioner rests.

CERTIFICATE

I, James R. Royce, do hereby certify that I am official court reporter for the above-entitled Court, and as such was in attendance upon the hearing of the foregoing matter.

I further certify that the above transcript is a true and correct record of the matters as therein set forth.

/s/ JAMES R. ROYSE,

Official Court Reporter.

[Endorsed]: Filed: Sept. 13, 1946. [14]

[Title of District Court and Cause.]

June 11, 1946

Black, J.

(Final argument by counsel—recess.)

The Court: We will proceed with the matter of Paul John Hunt.

Mr. Newton: Mr. Burch desires to ask the witness a couple of more questions.

The Court: Are you satisfied that he may do so?

Mr. Newton: Yes.

The Court: The case is again reopened.

PAUL JOHN HUNT

having been previously sworn, was recalled and testified as follows:

Direct Examination

By Mr. Burch:

Q. Before the injunction was served upon you how many [1*] sales were made in interstate com-

(Testimony of Paul John Hunt.)

merce outside of the state of Washington?

A. Well, I personally admitted only one.

Q. Well, just explain to the court how that one or any other one than that was made. How many were made?

Mr. Newton: If the court please, I object to this line of questioning. The decree was entered, that there was a violation of the Securities Act, and the contemnor consented and admitted the allegations of the complaint which are on file. The complaint specifically alleges the Securities Act had been violated. Now, to what extent it had been violated, it does not seem to me to be relevant to a contempt proceeding.

Mr. Burch: If your Honor please, the object of these questions is this, that they go to show that there was no willful engaging in sales in interstate commerce. There were only two sales made; and they were made under the most extenuating circumstances.

Mr. Newton: If the court please——

Mr. Burch: In other words, we are not charged with fraud. We are not charged with anything willful, but there were two inadvertent sales, one in Nevada and one in California. The whole matter is based upon those two, and I would like to show that they [2] were made under the most extenuating circumstances and without solicitation; yet they were made.

Mr. Newton: I renew my objection to the line

* Page numbering appearing at foot of page of original certified Transcript of Record.

(Testimony of Paul John Hunt.)

of questioning. The question of good faith as to the sales made upon which entry of the decree was based is not before the court. If we want to thresh that out, the only way naturally we can go into it would be to call the witnesses, the persons who bought this and bring out the exact circumstances under which they bought it. I don't think it is properly before the court, and we did not even think of subpoenaing such witnesses.

The Court: Well, counsel, I take it that this defendant is seeking to present this evidence for the purpose of mitigating the penalty in event the court should determine that there has been contempt. On that phase I take it the court is entitled to hear the evidence. The fact that the court hears it does not mean that the court subscribes to the fact that a man can come into court and consent to a judgment against him when plaintiff might have witnesses available and then thereafter, if the witnesses are no longer available, seek to undo the judgment which he consented to. But the fact that the court might not allow this evidence for the purpose of vacating [3] the judgment would not necessarily mean that the court was not permitted to hear it for such light, if any, as it might throw upon the question of contempt and the grievousness thereof. Objection overruled.

A. The sale made in California, which I admitted,—in that case the original purchaser of a lease——

(Testimony of Paul John Hunt.)

Q. I am sorry. Which one are you talking about?

The Court: California.

A. I was trying to think of the name, Mr. Newton. Do you know the name, Mr. Weber? Anyway, the sale was made to a woman named Purcell living in Fresno, California. Part of that time her mother and father, while living in Seattle, subscribed for a lease. Before it was completely paid, the father died. The mother moved to California to make her home with the daughter, and later assigned that interest to the daughter, and the daughter completed the payment. Some time later, several months later, the daughter mailed in a subscription for an additional interest, which was accepted.

Q. Now, I wish you would explain to the court how the sale in Nevada occurred?

A. You mean in Idaho?

Q. I mean in Idaho.

A. The first I knew of that sale was when it was brought [4] to my attention by the representative of the commission. It was a sale made to a person who bought leases while living in Spokane, Washington. Later she married a man living in Mullan, Idaho; and on one of her frequent visits to Spokane, according to my Spokane representative, she made an additional purchase, stating to our Spokane representative——

Mr. Newton: I object to that as hearsay.

The Court: I think so.

The Witness: As far as I am concerned, there

(Testimony of Paul John Hunt.)

was no sale made in Idaho. As far as my records are concerned, it came to me with a Spokane address.

Mr. Burch: That is all.

Cross Examination

By Mr. Newton:

Q. Mr. Hunt, you had carried an address for Mrs. Lusian at Idaho?

A. That is correct.

Q. You carry an address for her in Mullan, Idaho. As a matter of fact, she lived there for four years, isn't that a fact?

A. That is not my understanding.

Q. You did send her literature to Mullan, Idaho?

A. Yes.

Q. And you received money from her from Mullan, Idaho? [5]

A. I don't recall as to that. Payments were made through the Spokane office.

Q. You sent securities to her at Mullan, Idaho, through the mail?

A. I cannot say as to that; I don't know.

Q. The only address you had for her is Mullan, Idaho, is that correct?

A. No, we had an address for several years in Spokane.

Q. I mean the only address, current address, you had was Mullan, Idaho.

A. I believe that is true, yes.

Q. Now, you mentioned the Purcell sale in Cali-

(Testimony of Paul John Hunt.)

fornia and the circumstances surrounding it. Now, that was not the only sale in California, was it?

A. I believe it was.

Q. Are you familiar with the Sergeant Wertzbaugher sale, made to Wertzbaugher when he was in Spokane.

A. Except from the information I got from the Spokane representative.

Q. You didn't check up from your own records where he lived?

A. Oh, I discussed the matter after this investigation started with my Spokane representative and was told the circumstances concerning the sale.

Q. Did you determine whether or not he was a resident [6] of Los Angeles or Spokane at the time he made the purchase?

A. The original sale was not made to him. It was made to a resident of Spokane, and he assigned to him; if you are speaking of the soldier.

Q. Yes, the soldier lived in San Francisco, and, as a matter of fact he lives in Los Angeles. I talked with him there.

A. I understand he left there.

Q. You had no information of Sergeant Wertzbaugher being on a visit to Spokane and Sergeant Wertzbaugher giving the check? Did you ever see the check given by Sergeant Wertzbaugher to your Spokane representative?

A. I have never seen it.

Q. Did you ever check up on who paid the money? A. No.

(Testimony of Paul John Hunt.)

Q. You don't know. What about the sale to Mrs. Ashmore in St. Petersburg?

A. She made the statement in writing that she was only a temporary resident and she expected to return after the war.

Q. At the time you made the sale didn't you know she changed her mind and she so advised you?

A. No.

Q. What about the Gerlinger sale in Minnesota? [7]

A. I know nothing about it.

Q. That was made by some of your agents, was it?

A. I don't know anything about a sale there.

Q. You know there was a sale made to Mr. George Gerlinger in Minnesota, a resident of Minnesota?

A. No, I had no personal knowledge of such a sale, no. Neither did my office.

Q. Mr. Hunt, you have agents outside of Seattle, do you not? A. Yes.

Q. You have an agent in Spokane?

A. Yes.

Q. And you have maintained an office in Spokane? A. Yes.

Q. You maintain an office in Yakima.

A. Yes.

Q. And have a representative there?

A. Yes.

Q. And have agents in Seattle? A. Yes.

(Testimony of Paul John Hunt.)

Q. And apparently these agents do make sales for you? A. That is right.

Q. For which you collect money?

A. That is right.

Q. Do you know all the sales they make? In connection [8] with the Mullan, Idaho, sale for instance, did you ever check the sale in Mullan, Idaho, made by the Spokane representative?

A. Except to discuss it with my Spokane representative after it was brought to my attention through this investigation.

Q. Your agents are all selling the same securities? A. That is right.

Q. The securities which they are selling are part of the same issues sold out of your office?

A. Yes.

Q. They are securities issued by you?

A. Yes.

Q. It is not a corporation; they are issued by you; you are the issuer? A. That is right.

Q. And you reside in Washington?

A. I do.

Mr. Newton: That is all.

(Witness excused.)

The Court: Both sides rest again?

Mr. Newton: The Petitioner has nothing further to offer.

The Court: Mr. Burch have you anything?

Mr. Burch: No. [9]

The Court: All right. Both parties rest again.

CERTIFICATE

I, James R. Royse, do hereby certify that I am official court reporter for the above-entitled Court, and as such was in attendance upon the hearing of the foregoing matter.

I further certify that the above transcript is a true and correct record of the matters as therein set forth.

/s/ JAMES R. ROYSE,
Official Court Reporter.

[Endorsed]: Filed: Sept. 18, 1946.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE UNITED
STATES CIRCUIT COURT OF APPEALS,
NINTH CIRCUIT.

Please take notice that the defendant, Paul John Hunt, whose address is 5103 Arcade Building, Seattle, Washington, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the order made and entered in the above-entitled action and filed in the office of the Clerk of the District Court of the United States for the Western District of Washington, Northern Division, on the 12th day of August, 1946, adjudging appellant guilty of contempt of Court on the charge of violating an injunctive order previously entered on February 18, 1946, under Civil Action

file No. 1480, in the said District Court, and ordering appellant to pay a fine of Four Hundred Dollars.

Dated at Seattle this 21st day of August, 1946.

LEWIE WILLIAMS,
FRED'K R. BURCH,
Attorneys for Appellant.

A true copy: Attest:

MILLARD P. THOMAS,
Clerk.

(Seal) By /s/ TRUMAN EGGER,
Chief Deputy.

[Title of District Court and Cause.]

DOCKET ENTRIES

June 4, 1946:

Filed Application for Order to Show Cause and Affidavit of W. Forbes Webber.

Filed Order to Show Cause June 11, 1946, 10:30 a. m.

Filed Order Authorizing Prosecution of Paul John Hunt.

June 10, 1946:

Filed Reporter's Transcript of Testimony re Consent Judgment.

June 11, 1946:

Filed Stipulation between Paul John Hunt & Securities Exchange Commission (Exhibits).

June 11, 1946:

Hearing had on Order to Show Cause Why Hunt Should not be held in criminal contempt for Violation of Injunction.

After closing argument, matter taken under advisement.

June 18, 1946:

Filed Marshal's Return on Order to Show Cause, etc.

July 29, 1946:

Ent. order fixing Aug. 5, 1946, 11 a. m. for Court's Decision on Contempt Proceedings now pending. Clerk to notify counsel and John Paul Hunt. (Counsel notified.)

Aug. 5, 1946:

Court finds Mr. Hunt in contempt and imposes a fine of \$400, without costs. Judgment to be presented Aug. 12, 1946, 11 a. m.

Aug. 6, 1946:

Filed Reporter's Transcript of Court's Oral Decision.

Aug. 12, 1946:

Filed & Ent'd Order and Judgment.

Ent'd order fixing supersedeas bond on appeal at \$400.00 to be filed by noon Aug. 13, 1946.

Aug. 13, 1946:

Filed Order for Deposit of Cash in Lieu of Stay Bond.

Aug. 21, 1946:

Filed Notice of Appeal to U. S. Circuit Court of Appeals.

Mailed copy of Notice of Appeal to James E. Newton.

Date August 24, 1946.

Attest:

MILLARD P. THOMAS,
Clerk.

(Seal) By /s/ TRUMAN EGGER,
Chief Deputy.

[Endorsed]: Filed: Aug. 21, 1946.

[Endorsed]: Filed in Circuit Court of Appeals
Sept. 3, 1946.

[Endorsed]: No. 11419. United States Circuit Court of Appeals for the Ninth Circuit. Paul John Hunt, Appellant, vs. Securities and Exchange Commission, Appellee. Transcript of Record Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division.

Filed: September 16, 1946.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals for the
Ninth Circuit.

No. 11419

UNITED STATES OF AMERICA, ex. rel.,
THE SECURITIES and EXCHANGE
COMMISSION,

Appellee,

vs.

PAUL JOHN HUNT,

Appellant.

Appellant hereby designated the entire transcript on appeal in the above cause for printing.

STATEMENT OF POINT UPON WHICH
APPELLANT INTENDS TO RELY ON
APPEAL.

1. The injunctive order made and entered on February 18, 1946, in cause No. 1480 in the United States District Court for the Western District of Washington, Northern Division, does not, either in terms or by implication, enjoin appellant from continuing his intrastate business and/or using the mails therein under the State Law which grants him that privilege. (R.7.)

2. To construe said injunction to be applicable to intrastate business and/or the use of the mails therein would be directly at variance with the terms of the Securities Act of 1933 as amended, which reads as follows:

“Nothing in this title shall affect the jurisdiction of the Securities Commission (or any agency or office performing like function) of any State or Territory of the United States, or the District of Columbia, over any security or any person.”

Sec. 18 of said Act.

3. Under the caption of “Exempted Securities” we find the following provision:

Sec. 3 (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities;*

“(a) (11) Any security which is a part of an issue sold only to persons resident within a single State or Territory where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.”

Securities Act of 1933 as amended. Sec. 3

(a) (11)

4. The foregoing section supplants the former Sec 5 (c) which reads as follows:

“(c) The provisions of this section relating to the use of the mails shall not apply to the sale of any security where the issue of which it is a part is sold only to persons resident within a single State or Territory, where the issuer of such securities is a person resident and doing business within, or, if a corporation, incorporated by and doing business within such State or Territory.”

Sec. 3 a (11) exempts intrastate business from the provisions of Section 5 of the Securities Act of 1933, as amended.

When the Decree of Permanent Injunction of February 18, 1946, was ordered and as a part thereof the court states: "Provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended." (R.7)

"(a) A security shall be exempt from the operation of such provisions of the Act as by their terms do not apply to an 'exempted security' or to 'exempted securities' if—(2) The business of such issuer is managed by such State or political subdivision or by a board of officers appointed by such State or political subdivision."

General Rules and Regulations under the Securities Exchange Act of 1934. Rule X-3 A 12-2. Also Testimony of Paul John Hunt. (R—)

5. That appellant has in no way infractia the terms of the injunctive order of February 18, 1946, issued in cause number 1480, and upon this appeal will rely upon the following undisputed facts.

"Since the decree of injunction against Paul John Hunt entered by this Court of February 18, 1946, however, the sale of such securities has been restricted exclusively to persons resident in the State of Washington."

Stipulation of Facts. By the Attorneys.
(R19)

6. "The defendant, Paul John Hunt with actual knowledge of the contents of said decree of injunction and of all the proceedings in said cause, Civil Action No. 1480, having since the entry of said decree of injunction on February 18, 1946, sold securities in the State of Washington and to residents of said state only." By the Court.

Order and Judgment (R.30)

7. That appellant at all times herein mentioned was doing business in the State of Washington under the permission of the Director of Licenses of said state. This fact is not denied nor even questioned by the appellee.

See Testimony of Paul John Hunt, (R—)

/s/ LEWIE WILLIAMS,

/s/ FRED'K R. BURCH,

Attorneys for Appellant.

[Endorsed]: Filed: Sept. 25, 1946.

No. 11419

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

PAUL JOHN HUNT,

Appellant,

vs.

SECURITIES AND EXCHANGE
COMMISSION,

Appellee.

UPON APPEAL FROM THE DISTRICT
COURT OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

HONORABLE LLOYD L. BLACK, *Judge*

OPENING BRIEF OF APPELLANT

LEWIE WILLIAMS

FRED'K R. BURCH

Attorneys for Appellant

Address:

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Seattle 4, Washington

FILED

NOV 21 1946

PAUL P. O'BRIEN,



SUBJECT INDEX

	<i>Page</i>
Jurisdiction of the Court.....	1
Statement of the Case.....	3
Questions Involved	8
Argument of the Case.....	10

TABLE OF CASES

	<i>Page</i>
Am. Jur., Vol. 11, page 16, sec. 14.....	17
Am. Jur., Vol. 11, page 17, sec. 15.....	18
Am. Jur., Vol. 11, page 19, sec. 18.....	18
<i>Bridge Co. vs. Kentucky</i> , 154 U. S. 204, 38 L. ed. 962.....	18
C. J. Vol. 12, page 12, sec. 10.....	19
C. J. S. Vol. 15, page 431, sec. 88.....	19
Federal Constitution, Tenth Amendment.....	16
Federal Constitution, Article 1, sec. 8, sub. sec. 3	16
Judicial Code, sec. 128.....	2
Judicial Code, sections 128-240.....	2
<i>National Labor Relations Bd. vs. Jones et al</i> , 301 U. S. 1, 81 L. ed. 893.....	17

Securities Act of 1933, sec. 22(a).....	2
<i>Schechter P. Corp. vs. U. S.</i> , 295 U. S. 495, 97 A. L. R. 947.....	18
<i>Sec. and Ex. Com. vs. Crude Oil</i> , 93 Fed. 2d 844, 17 Fed Supp. 164.....	19
U. S. C. A., Vol. 28, sec. 41.....	2
U. S. C. A., Vol. 28, sec. 225(e).....	2
U S. C. Title 15, sec. 77(r).....	11
U. S. C. Title 15, sec. 77c(a)(11).....	20

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

PAUL JOHN HUNT,

Appellant,

vs.

SECURITIES AND EXCHANGE
COMMISSION,

Appellee.

UPON APPEAL FROM THE DISTRICT
COURT OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

HONORABLE LLOYD L. BLACK, *Judge*

OPENING BRIEF OF APPELLANT

JURISDICTION OF THE COURT

This is an appeal from an order of the District Court of the United States for the Western District of Washington, Northern Division, in cause number 1560, wherein, upon a hearing, the court found appellant guilty of contempt of court on the grounds of infraction of certain terms of an injunctive order, issued in cause number 1480, and levied a fine therefor, and that appellant stand committed.

The Federal Courts have jurisdiction to determine issues arising out of the construction of Federal statutes (28 U. S. C. A. Sec. 41; Judicial Code, Sec. 24, Paragraph 8).

The Circuit Court of Appeals has jurisdiction to reverse judgments of the District Court (28 U. S. C. A., Sec. 225, (e) Judicial Code, Sec. 128).

Judisdiction to grant injunctions in matters arising in interstate commerce and to punish for an infraction thereof is specifically granted to the District Courts by Section 22 (a) of the Securities Act of 1933, which likewise authorizes review by this court pursuant to Sections 128 and 240 of the Judicial Code, as amended. Said section reads as follows:

“Sec. 22 (a) The district courts of the United States * * * shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto. * * * Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C. A., title 28, secs. 225 and 347.)”

It is conceded by all parties concerned that the United States District Courts have jurisdiction of all matters appertaining to the execution of the

terms provided in what is known as the Securities Act of 1933 as applied to interstate commerce, and that the Circuit Courts of Appeal have appellate jurisdiction thereof.

It is also conceded by all parties concerned that the said District Courts have jurisdiction to issue injunctions in said matters and to punish for infractions thereof and that the Circuit Courts of Appeal have appellate jurisdiction therein.

STATEMENT OF THE CASE

The appellant herein secured authority from the Director of Licenses of the State of Washington in October, 1939, to sell securities in said State and to use the mails in so doing and that said license was and is in full force and effect at all times herein mentioned. Printed record, Page 41.

Acting by and under the rights thus granted, appellant sold and delivered securities and used the mail in the state of Washington and to residents of said state only, save and except that two or three sales were made that could be, and were, construed by appellee to be sales in interstate commerce and the lower court so held.

Appellant, believing that said sales were within his rights, did not and had no desire to apply to the Security Exchange Commission for a registration statement as he had no desire nor intent to engage in interstate commerce.

On February 18, 1946, appellant was served with a complaint charging him with having made sales and using the mail in interstate commerce.

By stipulation appellant admitted having made said sales and using the mail without a registration statement. The number of that action is 1480.

Thereupon, and as of the same date, the Court issued an injunctive order reading as follows: Printed record Page 6.

“IN THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF
WASHINGTON NORTHERN DIVISION

Civil Action, File No. 1480

SECURITIES AND EX- CHANGE COMMISSION,	} DECREE OF PERMANENT INJUNCTION
<i>Plaintiff,</i>	
<i>v.</i>	
PAUL JOHN HUNT,	} DECREE OF PERMANENT INJUNCTION
<i>Defendant.</i>	

This cause coming on to be heard on the 18th day of February, 1946, on the verified complaint filed

herein, and Paul John Hunt, defendant, not contesting the allegations contained therein, and upon stipulation of the parties hereto, on the motion of the Securities and Exchange Commission, plaintiff, and the Court being fully advised in the premises,

IT IS HEREBY ADJUDGED, ORDERED AND DECREED that the defendant, Paul John Hunt, his agents, servants, employees, attorneys and assigns, and each of them, be enjoined from directly or indirectly:

(a) making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil or gas rights, or interests or instruments commonly known as securities, arising out of or in connection with the sale of assignments of oil and gas leases on land located in Yakima or Benton counties, Washington, or any other securities, through the use or medium of any prospectus or otherwise;

(b) carrying such securities or causing them to be carried through the mails or in interstate commerce by any means or instruments of transportation, for the purpose of sale or for delivery after sale;

unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the

Securities Act of 1933, as amended.

Done in open Court this 18th day of February, 1946.

(Signed) LLOYD L. BLACK,
United States District Judge''

On June 4, 1946, appellant was served with a show cause order to appear before the Court on June 11, 1946.

This show cause order took the number of 1560 and was continued to August 12th, 1946, at which date the Court issued the Order and Judgment from which this appeal is taken.

It reads as follows: Printed record, page 30.

“IN THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF
WASHINGTON NORTHERN DIVISION
IN THE MATTER OF } No. 1560
PAUL JOHN HUNT } ORDER
AND JUDGMENT

This matter having come on before this Court for hearing the 11th day of June, 1946, on application of the Securities and Exchange Commission, and James E. Newton having been appointed and directed to prosecute the defendant Paul John Hunt on behalf of this Court, and it appearing to the Court from the stipulation on file in the matter and the evidence adduced at that time that Paul John Hunt did violate the decree of permanent injunction

entered by this Court on February 18, 1946, in the matter of Securities and Exchange Commission, Plaintiff, v. Paul John Hunt, Defendant, Civil Action File No. 1480, as set forth in the application of Securities and Exchange Commission, the defendant Paul John Hunt with actual knowledge of the contents of said decree of injunction and of all the proceedings in said cause, Civil Action No. 1480, having since the entry of said decree of injunction on February 18, 1946, sold securities in the State of Washington and to residents of said state only, which securities are identical in every respect and part of the same issue, offering, general plan of financing and for the same purpose as those securities sold prior to said decree to the residents of Washington, Idaho, and California, the sale of which securities said decree restrained and enjoined, and the mails having been used in the sale and delivery after sale of such securities by the defendant Paul John Hunt since the entry of said decree on February 18, 1946, no registration statement being in effect with the Securities and Exchange Commission and no exemption from the provisions of Section 5 of the Securities Act of 1933, as amended, being available with respect to such securities.

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Paul John Hunt be and is hereby held in contempt of this Court for violation of the decree of permanent injunction entered against him on February 18, 1946, in the matter of Securities and Exchange Commission v. Paul John Hunt, as charged in the application of Securities and Exchange Commission on file herein; and,

IT IS FURTHER ORDERED that the contemnor Hunt pay a fine to the United States of America

in the sum of \$400.00 and shall stand committed until said fine is paid.

Done in open Court this 12th day of August, 1946.

(Signed) LLOYD L. BLACK

United States District Judge''

In the preface to the above Order and Judgment the Court states the fact to be:

“The defendant Paul John Hunt with actual knowledge of the contents of said decree of injunction and of all the proceedings in said cause, Civil Action No. 1480, having since the entry of said decree of injunction on February 18, 1946, sold securities in the State of Washington and to residents of said state only.” Printed record, Page 31.

In further substantiation of this fact we quote from the stipulation of the parties and their attorneys:

“Since the decree of injunction against Paul John Hunt entered by this Court on February 18, 1946, however, the sale of such securities has been restricted exclusively to persons resident in the State of Washington.”

Printed record, Page 20.

QUESTIONS INVOLVED

1. Does the injunction issued in cause No. 1480 on February 18th, 1946, either in terms or implica-

tions, apply to intrastate business conducted under and by virtue of a license duly granted by the State?

2. Do the Federal Courts have a right to enjoin any privilege granted by a state in intrastate commerce unless said action is fraudulent and contrary to rules promulgated in interstate commerce and deleterious to the just application thereof?

3. Must any party who is duly authorized to carry on intrastate commerce within a State apply to the Securities and Exchange Commission for a "registration statement," and "a prospectus that meets the requirements of section 10 of the Securities Act of 1933?"

4. Does an inadvertent sale in interstate commerce made by one duly authorized to conduct an intrastate business clothe the Securities and Exchange Commission with any jurisdiction over intrastate business?

5. Does a sale in interstate commerce of any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or if a corporation, in-

incorporated by and doing business within, such State or Territory, make the entire issue of said securities subject to the exclusive jurisdiction of the Securities and Exchange Commission and thereby nullify the exemption provided in Sec. 3 (a) (11) of the Securities Act of 1933?

The lower court answered "Yes" to each of the foregoing questions and thereby erred in each instance.

ARGUMENT OF THE CASE

Since October, 1939, appellant has conducted an intrastate business by sale and delivery of securities in the state of Washington, being duly authorized so to do by said state. Printed record, Page 41.

While so doing two or three sales were inadvertently made which could be construed as interstate commerce, and was so construed by the court and on February 18th, 1946, appellant was enjoined from making any more sales in interstate commerce.

Since the issuance of said injunction appellant has made no sales in interstate commerce but has

continued in intrastate commerce exclusively.

On the 12th day of August, 1946, the lower court, construing the doing of intrastate business to be an infraction of said injunction, found appellant guilty of contempt of court.

In adopting the view indicated by the lower court in answer to the five questions involved, the said court, while construing the terms of the Securities Act of 1933, was called upon to ignore one of the most important provisions of said Act which reads as follows:

“Sec. 18. Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person.”
U. S. C. Title 15, Sec. 77 (r.)

The court by ignoring said Sec. 18 and proceeding under a self constituted jurisdictional right, would cause anyone engaged in legitimate intrastate commerce to be held guilty of contempt of court unless he first, observe and obey the terms of the Security Act as applied to interstate commerce, second, apply to the Securities and Exchange Commission for a “registration statement” and a prospectus

that meets requirements of section 10 of the Securities Act of 1933, and third, must be able to determine beyond a doubt that every purchaser is a bona fide resident of the state and whether absence from the state is, or will be, temporary or the establishment of a foreign residence.

Failing in any one of these requirements he becomes, at once, subject to an injunctive order prohibiting him from conducting any further intrastate business no matter what the consequences may be to him or to his clientele who are thus called upon to be sacrificed.

This is a condition which neither Congress nor the Securities Commission ever intended to establish.

It is compatible with any reasonable intendment that anyone doing a legitimate intrastate business and who enters the interstate field, can and should be enjoined from so doing and the persistence in insisting upon such conduct is the only grounds for contempt.

In the present case an injunctive order was issued, not only enjoining appellant from continuing in interstate business but which appellee stoutly main-

tains prohibits the doing of intrastate business without qualifying to do interstate business.

The foregoing claim leads to a very unreasonable climax.

Aside from the legal aspect above presented and assuming, for the purpose of argument only, that the injunctive order issued in cause No. 1480 on February 18th, 1946, was controlling in all respects, a diagnosis of said injunctive order becomes necessary. Said order enjoins appellant:

1st, From: "Making use of any means or or instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, etc."

2nd, From: selling "any securities through the use or medium of any prospectus or otherwise."

3rd, From: Carrying such securities or causing them to be carried through the mails or in interstate commerce.

It will be noted that all these prohibited acts are aimed at transactions in interstate commerce. If

applied to intrastate commerce, it is by a very strained presumption; one leading to an occult conclusion.

For instance, in question number 1, "From making use of any means or instruments of transportation or communication in interstate commerce" is clear, but the expression "or of the mails" provides a very broad grounds for presumption and presumption only.

It does not state how, when, where or under what circumstances appellant can or cannot use the mails. Taken literally appellant cannot use the mails to send a letter to some dear friend congratulating him or her upon their birthday.

The only reasonable construction to be placed upon this condition is that appellant is enjoined from using any means or instruments of transportation or communication or of the mails in interstate commerce to sell, etc.

The same condition obtains in the matter of the use of any prospectus. It nowhere designates when, how, or where this prospectus may or may not be used and considering the question arises from a federal statute dealing with interstate commerce,

and with that alone, we cannot but conclude that the prohibition is addressed to the use of a prospectus in interstate commerce, and interstate commerce only.

In the case at bar appellant has been for several years engaged in a legitimate intrastate business and the Securities Exchange Commission, well knowing and conceding that it had no jurisdiction in the matter, never interfered. It was not till it became aware of a few sales which might be construed to be interstate sales that it sought, and was entitled to, an injunction from continuing to make interstate sales.

For some reason which does not appear upon the surface, yet seems to be quite controlling, the Commission concludes that this simple fact, these few sales in interstate commerce, no matter how inadvertent and unintentional they may be, clothes the Securities Exchange Commission with full and complete jurisdiction of both interstate and intrastate commerce, even to the extent of a complete nullification of all intrastate rules and regulations.

It will be noted that appellant is not charged with fraud in any instance. The only charge levied

against him is that he invaded the field of interstate commerce without first procuring a "registration" and a "prospectus" from the Securities Exchange Commission and that he used the "mails" in so doing. Hence, there being no fraud charged, appellee was compelled to assume that it could deny appellant the right to use the mails in intrastate commerce, or at all, fraud or no fraud. Such an assumption of dictatorial power is not permitted in the U. S. A.

The distinction between "interstate" and "intra-state" is clearly enunciated in the tenth amendment to the Federal Constitution:

"The powers not delegated to the United States by the constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people."

The only power delegated to the United States in the matter of "regulating commerce" is contained in Article I, Sec. 8, Sub-section 3, of the Federal Constitution, which reads as follows:

"The congress shall have power,—To regulate commerce with foreeign nations and among the several states and with the Indian tribes."

Since the issuance of the injunction of February 18th, 1946, Appellant has in no way dealt with foreign nations nor among the several states, nor an Indian tribe, hence, is not in contempt of any order which Congress or the Securities Exchange Commission is authorized to promulgate.

“The power of Congress does not extend to the purely internal or intraterritorial commerce of the states.”

Vol. 11, Am. Jur., Page 16, Sec. 14.

“The authority of the Federal Government may not be pushed to such an extreme as to destroy the distinction, which the commerce clause itself establishes, between commerce among the several states and the internal concerns of a state. That distinction between what is national and what is local in the activities of commerce is vital to the maintenance of our Federal system.”

National Labor Relations Bd. vs. Jones and L. Steel Corp., 301 U. S. 1, 81 L. ed. 893.

“The power of Congress must be considered in the light of our dual system of government and may not be extended to embrace effects upon interstate commerce so indirect and remote that to do so, in view of our complex society, would effectually obliterate the distinction between what is national and what is local and would create a completely centralized government.

If the effect of intrastate transactions upon interstate commerce is merely indirect, such transactions remain within the domain of the state power."

Vol. 11 Am. Jur. Page 17, Sec. 15.

"If the commerce clause were construed to reach all enterprises and transactions which could be said to have an indirect effect upon interstate commerce, the Federal authority would embrace practically all the activities of the people and the authority of the state over its domestic concerns would exist only by sufferance of the Federal Government. Indeed, on such a theory, even the development of the State's commercial facilities would be subject to Federal control."

Schechter Poultry Corp. vs. U. S., 295 U. S. 495, 79 L. ed. 1570. 97 A. L. R. 947.

"The power over commerce not delegated to the Federal Government by the constitution are reserved to the states. It is the rule—which is as well established as is the rule that the regulation of commerce with other nations, states, or the Indian tribes, belongs solely to Congress—that the states retain exclusive control over that commerce which is completely internal, which is carried on between one person and another in a state, and which does not extend to or affect other states. As to such commerce, the states have plenary power and Congress has no right to interfere."

Vol. 11 Am. Jur., Page 19, Sec. 18. Sec. C. and C.

Bridge Co. vs. Kentucky 154 U. S. 204, 38 L. ed. 962.

"A state has an inherent and reserved right to regulate local, domestic and internal commerce. The question whether a state statute is in violation of the commerce clause of the federal constitution

does not arise where it is sought to apply the statute to purely internal commerce, and, in such case, the decision of the interstate commerce commission, or the acts of congress on which they are based, are not binding."

12 C. J., Page 12, Sec. 10.

"A provision of the Securities Act of 1933, as amended, 15 U. S. C. A., Sec. 77 e (a), making it unlawful to make use of any means or instruments of transportation or communication in interstate commerce to sell, offer to buy, or deliver a security as to which a registration statement is not in effect is a valid exercise of congressional power."

15 C. J. S., Page 431, Sec. 88.

Sec. and Ex. Com. vs. Crude Oil, 93 Fed. 2nd. 844.

17 Fed. Supp. 164.

It will be noted that this decision deals with interstate commerce only. It in no way extends any jurisdictional rights over intrastate commerce.

In the Decree and Injunction bearing date of February 18th, 1946, occurs the following reservation:

"Provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended."

Printed Record Page 7.

In the Order and Judgment pronounced in cause No. 1560, and from which this appeal is taken, the Court states:

“And the mails having been used in the sale and delivery after sale of such securities by the defendant Paul John Hunt since the entry of said decree on February 18, 1946, no registration statement being in effect with the Securities and Exchange Commission and no exemption from the provisions of Section 5 of the Securities Act of 1933, as amended, being available with respect to such securities.”

Printed record, Page 31

Original T. of R.. Page 31.

Originally, said Section 5 contained a sub-section 5 (c) which has been supplanted by Sec. 3 (a) (11). This supplanting Sec. reads as follows:

“Sec. 3 (a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities: * * * (11) Any security which is a part of an issue sold only to persons resident within a single State or Territory. Where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.”

U. S. C. Title 15, Sec 77 (a) (11)

In construing the law applicable to said Sec. 5, the lower court failed to give the original sub-section (c) or the supplanting Sec. 3 (a) (11) any consideration whatsoever.

We respectfully maintain that since the injunctive order of February 18, 1946, was issued, "Any security" sold by Mr. Hunt is a *part of an issue* sold only to persons resident within a single State or Territory."

In other words, any security sold only to persons resident, etc., whether sold as one transaction or as a part of an *issue so sold* is entitled to exemption from the terms of the Securities Act of 1933.

To construe this sub-section to mean, that, "any security which is a *part of an issue* sold only to persons resident within a single State, etc., means that if *any other part of said issue* is sold to a non-resident it completely nullifies the exemption right so clearly provided in said sub-section and automatically gives the Federal Government complete jurisdiction of intrastate commerce; is clearly erroneous.

Respectfully submitted,
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IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

No. 11419

PAUL JOHN HUNT,
Appellant,
vs.

SECURITIES AND EXCHANGE COMMISSION,
Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION.

BRIEF FOR APPELLEE

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TABLE OF CONTENTS

	Page
Jurisdiction	1
Questions Involved	1
Statute Involved	1
Counter-Statement of the Case	2
Argument	5
I. Appellant's Sales of Securities Effected After the Injunctive Decree by the Wholly Intrastate Use of the Mails Were in Contempt of That Decree	7
a. The Injunction Entered on February 18, 1946, Clearly Included Within Its Prohibitions Sales by the Intrastate Use of the Mails	7
b. The Exemption from the Provisions of Section 5 of the Securities Act Contained in Section 3(a) (11) Is Not Available if Any Part of the Issue Involved Is Sold to Non-Residents	10
II. Appellant May Not Attack the Validity of the In- junction in This Action	12
Conclusion	15

CITATIONS

Text:

<i>Badders v. United States</i> , 240 U.S. 391	14
<i>Clark v. Federal Trade Commission</i> , 128 F.2d 542, 543 (C.C.A. 9, 1942)	13
<i>Edwards v. United States</i> , 312 U.S. 473	12
<i>Electric Bond & Share Co. v. Securities and Exchange Commission</i> , 92 F.2d 580 (C.C.A. 2, 1937)	14
<i>Grimm v. United States</i> , 156 U.S. 604	14
<i>Howat v. Kansas</i> , 258 U.S. 181	13

<i>E. Ingraham v. Germanow</i> , 4 F. 2d 1002 (C.C.A. 2, 1925) .	13
<i>Jackson, ex parte</i> , 96 U.S. 727	14
<i>Lewis Publishing Co. v. Morgan</i> , 299 U.S. 288	14
<i>Public Clearing House v. Coyne</i> , 194 U.S. 497	14
<i>Rapier, In re</i> , 143 U.S. 110	14
<i>Securities and Exchange Commission v. Boise Petroleum Corp.</i> (D. Idaho, No. 1974, July 7, 1937, unreported) 1 S.E.C. Jud. Dec. 395	9
<i>Securities and Exchange Commission v. Sunbeam Gold Mines Co.</i> , 95 F. 2d 699 (C.C.A. 9, 1938)	12
<i>Securities and Exchange Commission v. Timetrust, Inc.</i> , 28 F. Supp. 34 (N.D. Calif. 1939)	9, 15
<i>Shaw v. United States</i> , 131 F. 2d 476 (C.C.A. 9, 1942)	9, 11
<i>United States v. Alluan</i> , 13 F. Supp. 289 (N.D. Tex. 1936)	9
<i>Western Fruit Growers, Inc. v. Gotfried</i> , 136 F. 2d 98 (C.C.A. 9, 1943)	13

Statutes:**Securities Act of 1933:**

Section 3(a) (11)	2, 6, 9, 10, 11, 12
Section 3(b)	6
Section 4(1)	6
Section 5	1, 3, 6, 8, 10, 12, 13
Section 5(a)	1, 5, 7, 8, 11, 14
Section 5(a) (1)	3, 7
Section 5(a) (2)	3, 7
Section 5(b)	8
Section 5(c)	9, 11, 12
Section 12(2)	8
Section 17	15
Section 17(a)	5, 8
Section 17(b)	8
Section 18	1, 2, 13, 14, 15
Section 20(b)	5
Section 23	5

CITATIONS—*Continued*

<i>Miscellaneous:</i>	Page
H.R. 85, 73d Cong., 1st Sess., p. 7	11
H.R. 85, 73d Cong., 1st Sess., pp. 10-11	15
H.R. 1838, 73d Cong., 2d Sess., pp. 40-41	12
H.R. 4314, 73d Cong., 1st Sess.	8
S. 875, 73d Cong., 1st Sess.	8

JURISDICTION

The basis for the jurisdiction of the District Court and of this Court is set forth in appellant's brief.

QUESTIONS INVOLVED

I. Where appellant sold unregistered securities to residents of several states in violation of Section 5(a) of the Securities Act of 1933, not being entitled to the exemption therefrom accorded to an issue sold only to residents of a single state, and hence has been enjoined from selling unregistered securities in interstate commerce, or by use of the mails, except as to securities or transactions exempted by the Act from Section 5 thereof—are his sales of securities of the same issue subsequent to the decree by the wholly intrastate use of the mails in contempt of that decree?

II. May appellant collaterally attack the permanent injunction in the course of a contempt proceeding by asserting that Congress has no power to regulate the intrastate use of the mails, that Section 5(a) of the Act is inapplicable to such use of the mails, and that Section 18 of the Act grants to the State of Washington sole jurisdiction over the sale of securities in that state, even though the mails are used in such sales? If so, -are these arguments valid?

STATUTE INVOLVED

The pertinent provisions of the Securities Act of 1933 are as follows:

Section 5(a), (15 U.S.C.A. §77e(a)) :

“Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate

commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

Section 3(a) (11), (15 U.S.C.A. §77c(a) (11)) :

"Sec. 3(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:

* * * *

(11) Any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

Section 18, (15 U.S.C.A. §77r) :

"Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person."

COUNTER-STATEMENT OF THE CASE

On or about January 1, 1940, appellant, Paul John Hunt, who resides and does business in the State of Washington, commenced selling certain securities pertaining to the assignment of oil and gas leases on land located in Yakima and Benton Counties, Washington, after procuring a license to sell securities from that state in October, 1939. Such sales were effected by the use of the mails and the instruments of interstate commerce and were made not only to residents of the State of Washington but also to residents of Idaho and California (R. 19). No attempt was made to

restrict such sales to residents of the State of Washington. At no time were the securities thus sold registered with the Securities and Exchange Commission as required by Section 5 of the Securities Act of 1933.

On February 18, 1946, the Commission applied to the District Court of the United States for the Western District of Washington, Northern Division, for an injunction restraining appellant from violating the provisions of Section 5 of the Securities Act of 1933 in the sale of such securities. It was alleged in the complaint that Hunt was and had been using both the mails and the means and instruments of transportation and communication in interstate commerce in effecting such sales and in delivering the securities after sale, in violation of Sections 5(a)(1) and 5(a)(2) of the Act because no registration statement was in effect with respect to such securities (R. 35-38). Hunt admitted the allegations of the complaint and consented to the entry of a decree pursuant to which he was enjoined from:

“(a) making use of any means or instruments of transportation or communication in interstate commerce, or of the mails, to sell investment contracts, certificates of interest or participation in a profit-sharing agreement, fractional undivided interests in oil or gas rights, or interests or instruments commonly known as securities, arising out of or in connection with the sale of assignments of oil and gas leases on land located in Yakima or Benton Counties, Washington, or any other securities, through the use or medium of any prospectus or otherwise;

“(b) carrying such securities or causing them to be carried through the mails or in interstate commerce, by any means or instruments of transportation, for the purpose of sale or for delivery after sale;

“unless and until a registration statement is in effect with the Securities and Exchange Commission as to such securities; provided that the foregoing shall not apply to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended.” (R. 6-8)

Affixed to the decree was the following consent signed by appellant and approved by his counsel:

“The undersigned defendant, Paul John Hunt, having read and considered the provisions of the foregoing judgment, and admitting the jurisdiction of the Court over him and the subject matter of this action, and admitting the allegations contained in the complaint on file in this cause, consents to the entry of this judgment.” (R. 8)

Despite this decree, appellant continued to sell the identical unregistered securities to which the complaint and decree related, using the United States mails within the State of Washington to acknowledge subscriptions, to forward the securities (R. 9-16), and to solicit additional subscriptions (R. 46-47).

The securities sold after the entry of the injunctive decree were identical in every respect with those sold prior to the decree, and were component parts of the same issue, all of them being sold as part of the same offering, issue, general plan of financing and for a single purpose (R. 20). On June 4, 1946, in response to an application by the Commission, an order to show cause why Hunt should not be held in criminal contempt for his actions subsequent to the entry of the injunction was granted (R. 17-18), and a hearing held (R. 41-60). Prior to the hearing, appellant signed a stipulation admitting the facts set forth above.

After the hearing, the Court adjudged Hunt in contempt and fined him \$400 (R. 30-32). This appeal is taken from that judgment.¹

¹ The Securities and Exchange Commission is designated herein as the “appellee”; it is rather the “relator” which called the facts constituting the contempt to the attention of the court. James E. Newton, of counsel herein, an attorney on the staff of the Commission, was appointed by the court to present the contempt case on behalf of the court (R. 2).

ARGUMENT

In considering the issues here presented it is important to keep in mind the regulatory pattern of the Securities Act of 1933.² The Act is designed to protect the investing public. It is primarily a disclosure statute which requires the seller to disclose pertinent information concerning securities publicly offered and sold through the mails or in interstate commerce, so that investors may be in a position to exercise an informed judgment as to such securities.

Issuers of securities are required to file a prescribed "registration statement" with the Commission and to provide investors with a "prospectus" containing certain of the information in the registration statement. Section 5(a) of the Act makes it unlawful to sell unregistered securities by the designated means; and Section 17(a) deals with fraud in the sale of securities. Under Section 20(b), the Commission is authorized to bring proceedings to enjoin violations and to refer wilful violations to the Department of Justice for prosecution.

It should be noted, moreover, that under the Act the Commission does not regulate the business of the issuer of securities or pass upon the merits of security offerings. The only prerequisite to registration is complete and accurate disclosure of the facts. See Section 23 of the Act, which makes it unlawful to represent, in respect of a registered security, that the Commission has "passed upon the merits of, or given approval to, such security."

Section 5 of the Act flatly prohibits the use of the mails or means of interstate commerce in the sale of unregistered securities. However, in other portions of the Act exemptions from Section 5 are provided. Of course, the conditions set

² Copies of the Act and of the Rules and Regulations adopted under it are being filed herewith for the convenience of the Court.

forth in these exemptive provisions must be met if they are to be utilized. Thus, a conditional exemption is provided in Section 3(a)(11) for any security which is sold only to persons resident within the state in which the issuer resides (or is incorporated) and does business. Section 4(1) of the Act provides an exemption from registration for transactions not involving a "public offering" of securities.

Section 3(b) gives the Commission the power to adopt exemptive rules in certain limited areas where it is appropriate in the public interest. Pursuant thereto the Commission has promulgated rules exempting under prescribed conditions offerings of securities the aggregate amount of which does not exceed \$300,000 in any twelve-month period. See Regulation A (Rules 220 to 224) of the Rules and Regulations under the Act. This exemption is available for certain types of securities upon filing with the Commission of certain brief information as well as copies of the sales literature; it is generally not available for oil and gas securities because offerings of such securities present unusual opportunities for fraud. The Commission in Regulation B (Rules 300-356) of the Rules and Regulations has adopted another exemption for offerings of oil and gas securities which do not exceed \$100,000, with somewhat different provisions as to disclosure. In general these regulations are designed to inform the Commission of the existence of these offerings in order that it may safeguard the public against fraud. At the same time in view of the nature of the offerings it was felt desirable to simplify the disclosure requirements as much as possible.

It thus will be noted that compliance with the Act can readily be effected either by registering the securities or by conforming to the terms or conditions of one of the various exemptive provisions contained therein. Appellant did neither.

I. APPELLANT'S SALES OF SECURITIES EFFECTED AFTER THE INJUNCTIVE DECREE BY THE WHOLLY INTRASTATE USE OF THE MAILS WERE IN CONTEMPT OF THAT DECREE.

- a. *The Injunction Entered on February 18, 1946, Clearly Included Within Its Prohibitions Sales by the Intrastate Use of the Mails.*

The bill of complaint filed by the Commission against appellant sought to restrain him from violating Sections 5(a) (1) and 5(a) (2) of the Act. The request for relief was phrased in the language of Section 5(a) of the Act, and asked that Hunt be enjoined against both the use of interstate channels and the use of the mails in connection with his sales activities. The decree, to which Hunt consented and which his counsel approved, was phrased in the identical words used by the Commission in its request for relief. The Act, the complaint, and the decree all refer to the sale of unregistered securities by the "use of any means or instruments of transportation or communication in interstate commerce or of the mails . . ." (emphasis supplied). Despite this clear and unmistakable language, appellant has chosen to read the disjunctive "or" as a conjunctive "and", contending that the decree is applicable only to interstate commerce, and that the use of the mails intrastate is not included within its scope.³

Such a construction would render the words "or of the mails" surplusage, for it is obvious that an interstate mailing would be a use of the "means or instruments of

³ Throughout his brief, appellant urges a variety of arguments dealing with the alleged impropriety of the regulation of the intrastate use of the mails. Since an analysis of these objections reveals that in substance they constitute a collateral attack upon the original decree, we have treated them *infra* at pp. 12-15. If the court should consider these arguments as relevant to a consideration of the construction of the decree, that discussion is applicable here.

transportation or communication in interstate commerce," which is set forth as the alternative prohibition in the decree. Since the decree specifically forbids the use of means or instrumentalities of interstate commerce in effecting sales of securities, it is clear that the contention of appellant must be rejected if the phrase "or of the mails" is to be accorded any meaning.

As we have noted, the Act itself provides that persons who do not comply with the provisions of Section 5 are to be deprived both of the right to use any means or instruments of transportation or communication in interstate commerce and of the right to use the mails. Appellant's argument is equally applicable to the words of the Act and would strip from it the jurisdiction which Congress exercised over the mails, thus affecting Sections 5(a), 5(b), 12(2), 17(a), and 17(b), all of which deal with interstate commerce and the mails in the alternative. Thus, reference to the Act itself shows the complete lack of merit in appellant's construction.⁴

⁴ Any possible doubt as to the meaning of Section 5(a) is resolved by the legislative history of that provision. As originally introduced it forbade "any person to make use of the United States mails or of any means or instruments of transportation or communication to offer in *interstate commerce* securities . . . for sale or to solicit or accept offers to buy such securities in such commerce . . . or to carry or cause to be carried in *interstate commerce* . . . any security . . ." (Emphasis supplied). H.R. 4314, 73d Cong., 1st Sess.; S. 875, 73d Cong., 1st Sess. When the language was changed to its present form the intention of Congress to enlarge the scope of the bill to include the intrastate use of the mails was made patent by its change in the preamble to the Act. Thus, the original preamble, which stated the bill was designed "to provide for the furnishing of information and the supervision of traffic in investment securities in interstate commerce," was changed to read: "A bill to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails."

That the draftsmen of the latter bill recognized that the provisions thereof would extend to sales consummated entirely within a single state if the mails were used in that state, is made clear by the insertion therein of Section 5(c), the present

Moreover, this interpretation was considered and rejected by this Court in *Shaw v. United States*, 131 F.2d 476, 480 (C.C.A. 9, 1942) :

“Appellant also contends that the carriage of the securities through the mails from one point in Los Angeles County to another is not the use of the mails in violation of the Securities and Exchange Act. There is no merit in this contention. The pertinent portion of the Act creating the offense reads ‘to carry or cause to be carried through the mails or in interstate commerce . . .’ The ‘or’ is disjunctive and the carriage through the mails is an element of the offense even though the carriage be intrastate.”

Accord: *Securities and Exchange Commission v. Boise Petroleum Corp.* (D. Idaho, No. 1974, July 7, 1937, unreported) 1 S.E.C. Jud. Dec. 395. See also *Securities and Exchange Commission v. Timetrust, Inc.*, 28 F. Supp. 34 (N.D. Calif. 1939) and *United States v. Alluan*, 13 F. Supp. 289, 292 (N.D. Tex. 1936).

In view of the plain words of the decree framed in conformity with the language of the statute, both of which clearly apply to intrastate use of the mails as well as their use interstate, it is evident, we submit, that the decree prohibited appellant from making use of the mails in any way in selling unregistered and non-exempt securities, and that appellant’s activities subsequent to the decree were in violation of it, since the only exemption contended for, that accorded by Section 3(a)(11), is unavailable, to which question we now turn.

Section 3(a)(11) of the Act, which exempts wholly local issues from registration. Under the original draft such a provision was of course unnecessary for only interstate commerce was regulated.

- b. *The Exemption from the Provisions of Section 5 of the Securities Act Contained in Section 3(a)(11) is Not Available if Any Part of the Issue Involved is Sold to Non-Residents.*

Prior to the entry of the injunction appellant engaged in the sale of unregistered securities to residents of several states by use of the mails and by use of instrumentalities of interstate commerce. In consenting to the injunction appellant acknowledged the unavailability of any exemption for these securities.⁵ Nevertheless, and despite the fact that appellant has admitted that the securities sold prior to the injunction and those sold thereafter were identical and parts of the same issue, and that certain of the securities comprising the issue were sold to non-residents of the state in which he was doing business, he now urges that the sales since the date of the injunction were entitled to the exemption from registration provided in Section 3(a)(11) of the Act, which exempts "any security which is part of an issue sold only to" residents of a single state. In so urging, appellant maintains that this exemption applies to any part of an "issue" of securities which is sold intrastate, even though other portions of that same issue are sold to residents of other states. The plain language of the Act negatives such a construction.

Section 5(a) of the Act is sufficiently broad to include within its scope all securities sold by means of the instrumentalities of interstate commerce or by any use of the mails. However, Section 3(a)(11) which was originally Section 5(c), removes from the operation of this section those security offerings which are consummated *in their entirety* within the state in which the issuer is resident (or incorporated) and doing business. The exemption is so

⁵ The injunction provided that its prohibitions should not apply "to any security or transaction which is exempt from the provisions of Section 5 of the Securities Act of 1933, as amended" (R. 7).

worded as to be available only to a security “which is a part of an issue sold only to persons resident within” the state in question. Once *any part of the issue* is sold to a person outside that state, the status of the offering as a wholly intrastate issue disappears and the exemption becomes unavailable for any securities of that issue. See *Shaw v. United States*, 131 F. 2d, at p. 480.

The pertinent language of Section 3(a)(11), which restricts the exemption to issues “sold *only* to persons resident within a *single* State” could not be more unequivocal. Moreover, it is manifest from the legislative history of the section that Congress clearly intended that when any part of a securities issue was offered or sold to a resident of a state other than that in which the issuer was resident (or incorporated) and doing business, the entire issue would lose its local character, and the exemption provided by Section 3(a)(11) would be inapplicable. The House Committee Report commented on this section as follows:

“Section 5(c) [now section 3(a)(11)] also exempts sales within a state of *entire* issues of local issuers.”⁶ (Emphasis supplied.)

When Section 3(a)(11) was adopted the House Committee Report repeated this limitation, stating:

“The new Section 3(a)(11) incorporates the existing Section 5(c) of the Act and further makes clear that the exemption is not limited to the use of the mails, if sales in the course of the distribution of the issue are limited to residents within a *single* state or territory.”⁷ (Emphasis supplied.)

⁶ H.R. 85, 73d Cong., 1st Sess., p. 7.

⁷ H.R. 1838, 73d Cong., 2d Sess., pp. 40-41. Section 5(c) exempted sales of such securities from only those provisions of Section 5 of the Act which related to the use of the mails. It gave no exemption from provisions relating to the use of any means or instruments of transportation or communication in interstate commerce. In replacing Section 5(c) with Section 3(a)(11) Congress made it clear that where its terms and conditions were complied with the exemption would apply to all of the provisions of Section 5 including the use of interstate channels.

Therefore, in view of the plain language used and of the legislative history of Section 3(a) (11), it is apparent that the exemption provided by that section is not available if any part of the issue is sold outside the state in which the issuer is resident (or incorporated) and doing business.⁸ By stipulation it is conceded that the issuer, appellant herein, was doing business in the State of Washington; that some sales were made to residents of other states; and all sales were of securities which were parts of a single issue. Thus, the exemption provided by Section 3(a) (11) is clearly unavailable to appellant.

The District Court considered all of the facts as to appellant's activities both before and after the decree, the circumstances under which the decree was entered and also the suggestion that appellant in conducting his sales activities since the entry of the injunctive decree had acted in reliance upon advice of counsel. It is clear that the Court's conclusion that appellant knowingly and intentionally violated the injunctive decree of February 18, 1946 was amply supported by the record.

II. APPELLANT MAY NOT ATTACK THE VALIDITY OF THE INJUNCTION IN THIS ACTION.

As we have demonstrated, the injunction clearly prohibited appellant from using the mails in selling unregistered securities. Notwithstanding that appellant consented to the entry of this injunctive decree, he now for the first time seeks to question its validity. He asserts that the Congress has no power to regulate the use of the mails in connection with a wholly intrastate business; that Section 5 of

⁸ The burden of establishing that a person is within a class excepted from the disclosure requirements of the Act, as this Court has held, is upon the person asserting the exemption. *S.E.C. v. Sunbeam Gold Mines Co.*, 95 F.2d 699 (C.C.A. 9, 1938); *Edwards v. United States*, 113 F.2d 286, 289 (C.C.A. 10, 1940) rev'd on other grounds, 312 U.S. 473, although sustained on this point (at p. 483).

the Act does not encompass transactions involving the intrastate use of the mails; and that Section 18 of the Act prohibits the court from restraining the intrastate use of the mails. All of these arguments constitute attempts to establish the impropriety and invalidity of the original decree enjoining appellant. As such, they may not be urged upon appeal from a judgment for contempt of that decree. *Western Fruit Growers, Inc. v. Gotfried*, 136 F.2d 98, 100 (C.C.A. 9, 1943); *Clarke v. Federal Trade Commission*, 128 F.2d 542, 543 (C.C.A. 9, 1942); *E. Ingraham v. Germanow*, 4 F.2d 1002, 1003 (C.C.A. 2, 1925). Only by direct appeal may the propriety of the injunction be tested.

Thus, the Supreme Court, in *Howat v. Kansas*, 258 U. S. 181, 189-190, stated:

“An injunction duly issuing out of a court of general jurisdiction with equity powers upon pleadings properly invoking its action, and served upon persons made parties therein and within the jurisdiction, must be obeyed by them however erroneous the action of the court may be, even if the error be in the assumption of the validity of a seeming but void law going to the merits of the case. It is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision is contempt of its lawful authority, to be punished.”

In any event we regard the objections to the original injunctive decree now urged by appellant as being without merit. Insofar as appellant questions the power of Congress to forbid the use of the mails intrastate, his position clearly is untenable. We submit that there can no longer be any question as to the power of Congress to forbid the use of the mails for purposes which it deems contrary to public policy, even though the activity affected may be confined to a single state.⁹

⁹ *Ex parte Jackson*, 96 U.S. 727; *In re Rapier*, 143 U.S. 110. *Public Clearing House v. Coyne*, 194 U.S. 497; *Grimm v. United States*, 156 U.S. 604; *Lewis Publishing Co. v. Morgan*,

Appellant also contends that Section 5(a) of the Act is not applicable where the only use of the mails is intrastate. We already have discussed this question in connection with our analysis of the injunctive decree, which follows the language used in Section 5(a).¹⁰ We believe that discussion fully answers this contention.

Finally, appellant advances the theory that the license to do business which he obtained from the State of Washington vested him with the right to conduct an intrastate business and to use the mails intrastate in furtherance of that business, regardless of the restrictions upon that right contained in the Securities Act. He bases this contention upon Section 18 of the Act, which provides:

“Nothing in this title shall affect the jurisdiction of the Securities Commission (or any agency or office performing like function) of any State or Territory of the United States, or the District of Columbia, over any security or any person.”

It appears that Section 18 was enacted in order to preserve the jurisdiction of state security commissions over transactions within their borders,¹¹ and not to limit the jurisdiction of the federal regulatory body. By enacting Section 18 Congress indicated that concurrent jurisdiction might be exercised over certain activities, but there is no indication there, or in any other portion of the Act, that Congress sought to withdraw from federal regulation so important an area as that which embraces the sale of securities intrastate through use of the mails. Appellant's claim of sanctuary under Section 18 was also suggested by the defendant in *S.E.C. v. Timetrust, Inc., et al.*, 28 F. Supp. 34 (N.D. Calif., 1939), an action under Section 17 of the Act. There the court, in rejecting this claim, stated (at p. 41) :

299 U.S. 288; *Badders v. United States*, 240 U.S. 391, 393; *Electric Bond & Share Co. v. S.E.C.*, 92 F. 2d 580, 583 (C.C.A. 2, 1937), *affirmed* 303 U.S. 419.

¹⁰ *Supra* pp. 7 to 9.

¹¹ See H.R. 85, 73d Cong., 1st Sess., pp. 10-11.

"There is no merit in the contention. The most that can be said for the section is that it probably gives concurrent jurisdiction to the Securities and Exchange Commission and the State authorities."

The objections urged by appellant, therefore, whether considered as a collateral attack upon the injunctive decree or upon any other basis, must fall in view of the authorities heretofore cited as well as the plain language of the Act.

CONCLUSION

For the reasons stated, it is apparent that appellant violated the injunctive decree of February 18, 1946 and was properly held in contempt thereof. Accordingly, the decision of the District Court should be affirmed.

Respectfully submitted,

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December, 1946.

No. 11419

United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

PAUL JOHN HUNT,

Appellant,

vs.

SECURITIES AND EXCHANGE
COMMISSION,

Appellee.

UPON APPEAL FROM THE DISTRICT
COURT OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE LLOYD L. BLACK, *Judge*

Reply Brief

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CLERK

I N D E X

	<i>Page</i>
15 U. S. C. A.....	2
Printed Record	4
Printed Record	4
59 C. J.....	7

United States
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HONORABLE LLOYD L. BLACK, *Judge*

Reply Brief

A perusal of Appellee's answering brief discloses the grounds upon which it declares that the conviction and fining of Appellant should be sustained. The points depended on are as follows:

1st. Are Appellant's sales of securities of the same issue subsequent to the decree by wholly intrastate use of the mails in contempt of that decree?

2nd. May Appellant collaterally attack the permanent injunction in the course of a contempt proceeding?

In support of question number one, Appellee cites numerous excerpts from the Securities Act of 1933 and seems quite content with the conclusion that said Act was promulgated, not only to be applied to interstate business, but also to intrastate commerce in its fullest and deepest meaning.

Having fully convinced itself thusly as to the status of interstate and intrastate commerce, it blandly and, seemingly, unconscious of its purport, quotes and adopts the following:

"Nothing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person."

Sec. 18, 15 U. S. C. A. Sec. 77 r.

In the face of this unequivocal provision we ask the question---Does the fact of pursuing intrastate commerce place one in contempt of an order prohibiting participation in interstate commerce. We respectfully submit that it does not.

For answer to question number two we admit that a party cannot collaterly attack a permanent injunction in the course of a contempt proceeding. This rule is supported by common sense. However, it must also be APPLIED by a rule of common sense *and legality*.

Appellee does not question the validity of the injunction when applied to interstate commerce. Nowhere in the record can any such an intimation be found. This appeal is not based upon any question as to the validity of the injunction but is based upon its illegal application and it is from this illegal application that appellant appeals.

From the injunction appellant had no right nor inclination to appeal; but from an erroneous and illegal application of the injunction appellee has the right to appeal and did appeal at the earliest opportunity.

That the injunction was ambiguous the Court remarked in its Oral Decision:

“I think the decree could have been a bit plainer than it was, that is the decree of February 18, 1946.”

Printed Record, Page 26.

This shows that this appeal is in no way allied to the injunction itself but rests exclusively in the construction and application of the same, a matter in which Appellant has a right of appeal.

In Appellee's COUNTER-STATEMENT OF THE FACTS it very adroitly seeks to convey the impression that Appellant was wilfully and maliciously invading the zone of interstate commerce per. se., and in a wholesale manner.

This impression is quite erroneous, for as said by the Court in its Oral Decision:

“However, I am satisfied that in imposing the sentence the Court should consider his (Appellant's) good faith and the good faith of his counsel.”

Printed record, page 26.

On page 7 of said brief under the heading of "APPELLANT'S SALES OF SECURITIES EFFECTED AFTER THE INJUNCTIVE DECREE BY THE WHOLLY INTRASTATE USE OF THE MAILS WERE IN CONTEMPT OF THAT DECREE", and in support of this conclusion states on the same page: "The Act, the complaint, and the decree all refer to the sale of unregistered securities by the use of any means *or* instruments of transportation *or* of the mails * * *" (emphasis supplied). And then goes on to remark:

"Despite this clear and unmistakable language, appellant has chosen to read the disjunctive 'or' as a conjunctive 'and', contending that the decree is applicable only to interstate commerce, and that the use of the mails intrastate is not included within its scope."

Appellee holds that the distinction between the disjunctive *or* and the conjunctive *and* is of the utmost importance, in fact decisive of the case at bar, and with this important distinction in mind charges that Appellant seeks to substitute *and* for *or*.

A reference to the facts will elucidate this problem.

The injunction issued on February 18th, 1946, is based upon the provisions of Sec. 5 (a) of both the original Act, and said Act as amended. Throughout said section the disjunctive "*or*" is used, while in the title to each of said Acts, the conjunctive "*and*" is used.

This being true the question as to what is the proper construction to be placed on such a condition arises, and what was the intent of Congress.

This rule is clearly announced as follows:

"Where, however, an error is such that one reading the title might be misled thereby, the title is insufficient; and a court cannot, under the guise of disregarding surplusage, reject a part of the title of an Act for the purpose of saving the Act, nor, on the other hand, can it supply omitted words in order to make the title conform to the body of the Act.

"Since a constitutional requirement that the subject of a statute be expressed in its title is generally regarded as mandatory, the title is an essential part of an act, and the subject expressed in the title fixes the limit of the valid scope of the act.

"The provisions of an Act must correspond with the

subject expressed in its title; so nothing can validly be included in the body of a statute which is not expressed in or covered by the title, and all parts of an Act which are not within its title are unconstitutional and void."

59 C. J., page 811, Secs. 392-393.

Observing the foregoing universal rule and applying it to the case at bar and in the eloquent language of Appellee, slightly paraphrased, we find that:

The Act, the complaint, and the decree all refer to the sale of unregistered securities by the use of any means '*or*' instruments of transportation '*or*' communication in interstate commerce '*or*' of the mails * * * (emphasis supplied) yet, despite the clear and unmistakable language (of the above rule of law) Appellee has chosen to read the conjunctive '*and*' as the disjunctive '*or*'; contending that the decree is applicable to both interstate and intrastate commerce, and that the use of the mails intrastate *is* included within its scope.

The title to the SECURITIES ACT OF 1933, both in the original and as amended reads:

AN ACT

“To provide full and fair disclosure of the character of securities sold in interstate *and* foreign commerce *and* through the mails, and to prevent frauds in the sale thereof, and for other purposes.”

This Act calls attention to: “The character of securities sold in interstate and foreign commerce and through the mails.”

It does not in any way delineate any securities, or when or where this “through the mails” is to apply; and the only lucid conclusion is that it applies to securities sold in interstate and foreign commerce through the mails.

It is unreasonable to conclude that the Act, in any way, includes the legal sale of local, intrastate securities sold “through the mails.” If it means that, it should have said so, and inasmuch as it does not do so, this explanation cannot be supplied by any extraneous course of reasoning.

We most respectfully maintain that Appellant in continuing the sale of securities in intrastate commerce

was in no way in contempt of the injunction issued on the 18th day of February, 1946, and the decision of the lower Court should be reversed.

Respectfully submitted,

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No. 11420

United States
Circuit Court of Appeals
For the Ninth Circuit.

PAUL A. PORTER, Administrator, Office of Price
Administration,

Appellant,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d.b.a. DOROTHY HANSCOM'S, a Co-part-
nership,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington
Northern Division

FILED

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No. 11420

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Circuit Court of Appeals
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PAUL A. PORTER, Administrator, Office of Price
Administration,
Appellant,
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DOROTHY HANSCOM and R. C. HANSCOM,
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Northern Division

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	PAGE
Answer	4
Appeal:	
Certificate of Clerk to Transcript of Record on	26
Designation of Contents of Record on	23
Notice of	22
Statement of Points to Be Relied on Upon	24
Statement of Points and Designation of Record on	71
Certificate of Clerk to Transcript of Record on Appeal	26
Complaint for Treble Damages	2
Court's Decision	67
Designation of Contents of Record on Appeal	23
Judgment	21
Motion to Substitute	13
Names and Addresses of Attorneys	1
Notice of Appeal	22
Opening Statement Presented by Attorney for Defendants	32

Opening Statement Presented by Attorney for the Plaintiff	31
Order Denying Motion of Plaintiff for Judg- ment on the Pleadings	18
Order for Substitution	14
Proceedings	29
Statement of Points and Designation of Record on Appeal	71
Statement of Points to Be Relied on Upon Ap- peal	24
Stipulation as to Facts	19
Stipulation re Overcharges in Amount of \$714.01	15
Witnesses for Defendants:	
Hanscom, Robert C.	
—direct	55
—cross	58
Hoff, Irvin A.	
—direct	33
—cross	48
Mills, Reed	
—direct	54
—recross	63
—redirect	65
Sollie, Ruth	
—direct	50
—cross	52

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In the District Court of the United States for the
Western District of Washington, Northern
Division

Civil Action No. 1446

CHESTER BOWLES, Administrator,
Office of Price Administration,
Plaintiff,
vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d. b. a. DOROTHY HANSCOM'S, a co-part-
nership,
Defendant.

COMPLAINT FOR TREBLE DAMAGES

Comes now the plaintiff, above-named, and for
cause of action against defendants above named,
alleges:

1. That the Office of Price Administration is an
agency of the Government of the United States of
America, created by the provisions of Section 201
(a) of the Emergency Price Control Act of 1942
(U. S. C. A. 901), as amended (56 Stat. 23, 765,
57 Stat. 566, P. L. 108, 79th Congress, First Ses-
sion), hereinafter referred to as the "Price Con-
trol Act", and that Chester Bowles, plaintiff herein,
is a duly appointed, qualified and acting adminis-
trator thereof.

2. That jurisdiction of this cause of action is
conferred upon the above entitled court by the
provisions of Section 205(c) of the Price Control

Act, and that said defendants now are, and have been, at all times, hereinafter mentioned engaged in the business of buying and selling commodities subject to Revised Maximum Price Regulation 330 (9 Fed. Reg. 11350; 10 Fed. Reg. 331, 10 Fed. Reg. 9960) hereinafter called "R.M.P.R. 330", which was issued pursuant to Section 2(a), Section 202 (b), and Section 201(d) of said Price Control Act with their principal place of business in King County within the jurisdiction of this court.

3. That the defendants have engaged in acts and practices hereinafter set forth which constitute a violation [2*] of Section 4(a) of the said Price Control Act in that they have violated R.M.P.R. 330, as amended, and that, therefore, pursuant to Section 205(e) of said Price Control Act, the Administrator brings this suit for treble damages.

4. That, at all times, from September 18, 1944, to and including January 1, 1946, said R.M.P.R. 330 had been and was in full force and effect establishing the maximum prices that could be charged for Women's, Girls', Children's and Toddlers' outerwear garments.

5. That defendants have made sales to purchasers for use or consumption other than in the course of trade or business of commodities subject to R.M.P.R. 330 at prices in excess of the maximum prices established by R.M.P.R. 330, as amended. That said sales were made more than thirty days prior to the filing of this complaint.

* Page numbering appearing at foot of page of original certified Transcript of Record.

Wherefore, plaintiff, prays the court for:

1. Judgment in favor of the plaintiff and against the defendants for three times the amount by which the prices charged by the defendants for said garments exceeded the maximum prices allowed for said garments under R.M.P.R. 330.

2. And for such other and further relief as the court may deem just and equitable in the premises.

/s/ FREDERICK W. POST

Apparel Enforcement Attorney.

/s/ DANIEL M. REAUGH

District Enforcement Attorney.

Attorneys for Plaintiff

[Endorsed]: Filed Jan. 22, 1946. [3]

[Title of District Court and Cause.]

ANSWER

Comes now the defendants, Dorothy Hanscom and R. C. Hanscom, d.b.a. Dorothy Hanscom's, and for answer to the complaint herein admit, deny and allege as follows:

I.

Referring to paragraphs 2, 3, 4 and 5 of the complaint herein, defendants deny each and every allegation therein contained save and except such

allegations contained therein as are hereinafter specifically admitted.

As a further answer and affirmative defense, defendants make the following allegations:

I.

That during the month of December, 1943, defendants commenced doing business as retailers of misses' and women's clothing in the City of Seattle, King County, Washington; that prior to the commencement of business defendant Dorothy Hanscom called in person on several occasions at the Seattle Office of Price Administration, and by that office she was instructed to use the pricing charts of Bests, Inc., of Seattle, as the pricing charts of Dorothy Hanscom's under Maximum Price Regulation 330, which was then the regulation controlling the establishment of pricing charts by defendants.

II.

That in compliance with said instructions of said Office of Price Administration, defendant Dorothy Hanscom obtained pricing charts from Bests, Inc., of Seattle, covering the various categories of merchandise which it was intended to deal in in the establishment of Dorothy Hanscom's, and these pricing charts were adopted by Dorothy Hanscom's [4] as that establishment's pricing charts under Maximum Price Regulation 330.

III.

That thereafter and during the month of De-

cember, 1943, Dorothy Hanscom's commenced doing business, and in the course of transacting said business sold many items of merchandise at prices lower than the ceilings fixed by the pricing charts which had been adopted as hereinabove stated and that at no time did said Dorothy Hanscom's make sales at prices higher than the ceilings fixed by the charts which had been adopted by defendants as hereinabove stated.

IV.

That this course of business continued until September, 1944; that on or about September 15, 1944, defendants received the following communication from the Seattle Office of Price Administration under the mimeographed signature of Reed C. Mills, District Price Executive, by Ruth Sollie, Apparel Section:

"September 14, 1944

"To All Dealers in Women's, Misses' and Children's Outerwear Garments:

"Revised Maximum Price Regulation No. 330, which governs the maximum prices to be charged for women's, children's and misses' outerwear garments, has just been issued and is effective September 18, 1944.

"According to this revised Regulation, it is necessary that you file two signed copies of the pricing chart, which you have previously prepared in conformance with Maximum Price Regulation No. 330, with the District Office of the Office of Price Administration, 3312 White Building, Seat-

tle, Washington, by October 15, 1944. You must keep a copy of the pricing chart for your own use. On and after November 15, 1944, you may not sell any garments subject to this Regulation unless you have received an acknowledgment from the OPA of the filing of your pricing chart.

“A copy of this revised Regulation will be sent to you by your local OPA Board as soon as they receive their supply.” [5]

That thereafter on or about October 8, 1944, defendants received from the Seattle Office of Price Administration over the mimeographed signature of Reed C. Mills, District Price Executive, by Ruth Sollie, Apparel Section, the following communication:

“Second Notice

October 7, 1944

“To All Dealers in Women’s, Misses’ and Children’s Outerwear Garments:

“Revised Maximum Price Regulation No. 330, which governs the maximum prices to be charged for women’s, children’s and misses’ outerwear garments, has just been issued and is effective September 18, 1944.

“According to this revised Regulation, it is necessary that you file two signed copies of the pricing chart, which you have previously prepared in conformance with Maximum Price Regulation No. 330, with the District Office of the Office of Price Administration, 3312 White Building, Seattle, Washington, by October 15, 1944. You must keep a copy of the pricing chart for your own use. On and

after November 15, 1944, you may not sell any garments subject to this Regulation unless you have received an acknowledgment from the OPA of the filing of your pricing chart.

“A copy of this revised Regulation will be sent to you by your local OPA Board as soon as they receive their supply.”

That said Reed C. Mills and said Ruth Sollie were duly authorized and empowered representatives of plaintiff and were acting within the scope of their authority in sending these communications to defendants.

V.

That on or about October 12, 1944, defendants filed with the Office of Price Administration at Seattle all of the pricing charts of Bests, Inc., which defendants Hanscom had adopted as hereinabove described, and which defendants had been using as their pricing charts continuously from the time they commenced business in December, 1943; that under date of October 14, 1944, the Seattle Office of Price Administration [6] acknowledged receipt of the defendants' charts in the following communication:

October 14, 1944

“Dorothy Hanscom's
423 University St.
Seattle, Washington

Dear Miss Hanscom:

“We hereby acknowledge the receipt of two copies of the pricing chart which you have filed

under Section 3 of Revised Maximum Price Regulation No. 330.

“This acknowledgment is not to be considered as an approval of the factual or mathematical accuracy of the information on the pricing chart. Even though you have filed these figures, if they are incorrect, you are not permitted to take a higher percentage markup than that authorized by Revised Maximum Price Regulation No. 330. However, if you find that your pricing chart is incorrect, you may file an amended pricing chart setting forth the inaccuracies.

“If you file an amended pricing chart, you are not permitted to take a higher percentage markup than that previously reported, or permitted under Revised Maximum Price Regulation No. 330, whichever is lower, until you have received an acknowledgment from this office of the receipt of the amended pricing chart.”

VI.

That at no time prior to and including October 15, 1944, was a copy of Revised Maximum Price Regulation 330 available to defendants.

VII.

That after defendants filed their pricing charts with the Seattle Office of Price Administration during the month of October, 1944, defendants, having literally complied with the directions contained in the communications from the Office of Price Administration dated September 14, 1944, and Octo-

ber 7, 1944, and having no reason to question the factual or mathematical accuracy of the information contained in the pricing charts so filed, assumed and continued to assume until November, 1945, that they had complied with all of the regulations [7] of the Office of Price Administration which affected their business; that everything done by defendants as described herein was done in good faith pursuant to the orders communicated to defendants by the Office of Price Administration in the communications set forth in paragraph IV hereof.

VIII.

That on November 26, 1945, the Seattle Office of Price Administration advised the defendants that the charts which defendants had filed in response to the communications addressed to defendants by the Seattle Office of Price Administration on September 14, 1944, and October 7, 1944, were erroneously compiled and did not meet the requirements of Revised Maximum Price Regulation 330; this communication further advised defendants that under Revised Maximum Price Regulation 330 defendants should not have filed the pricing charts which the Seattle Office of Price Administration ordered defendants to file on September 14, 1944, and October 7, 1944, but that defendants should have filed a base period pricing chart based on deliveries by defendants of garments during the first four months immediately following the first delivery of garments by defendants; this communication further requested defendants to submit an

amended pricing chart under Revised Maximum Price Regulation 330; that defendants promptly complied with this request.

IX.

That because of the fact that during the four months immediately following the first delivery of garments by defendants in December, 1943, defendants actually sold some garments at prices lower than the ceilings established by the pricing charts which had been adopted by defendants as described in paragraph II hereof, the compilation of defendants' amended pricing chart, as requested by the Seattle Office of [8] Price Administration on November 26, 1945, and the application of that amended pricing chart to sales and deliveries made by defendants Hanscom during the period beginning January 22, 1945, and continuing to the present time showed that, according to this amended pricing chart defendants had made sales in the course of their trade and business at prices in excess of the maximum prices established by Revised Maximum Price Regulation 330 as amended; that the total amount of all of said overcharges was Seven Hundred Fourteen and 01/100 Dollars (\$714.01).

X.

That it is the position of the defendants that, because every act done by defendants herein was done in good faith and pursuant to express orders of the Seattle Office of Price Administration and with no intent or desire to violate any provision

of the applicable law or of any regulation, order, price schedule, requirement or agreement thereunder, plaintiff herein is estopped from prosecuting this action and that defendants are entitled to have the complaint herein dismissed with prejudice.

Wherefore, having fully answered the complaint of the plaintiff herein, defendants pray that said complaint be dismissed with prejudice.

MERRITT, SUMMERS,
BUCEY & STAFFORD

By MATTHEW STAFFORD
Attorneys for Defendants.

State of Washington,
County of King—ss.

R. C. Hanscom, being first duly sworn on oath deposes and says: That he is one of the defendants named in the foregoing answer; that he has read said answer, knows the contents thereof and believes the same to be true.

R. C. HANSCOM

Subscribed and sworn to before me this 2 day of April, 1946.

[Seal] MATTHEW STAFFORD

Notary Public in and for the State of Washington, residing at Seattle.

[Endorsed]: Filed April 12, 1946. [10]

[Title of District Court and Cause.]

MOTION TO SUBSTITUTE

Paul A. Porter by his counsel, respectfully informs the court that Chester Bowles, a party in this action, has resigned from the Office of Price Administrator of the Office of Price Administration. His resignation was duly accepted and said Paul A. Porter, whose appointment by the President for the Office of Administrator was confirmed by the United States Senate on February 21, 1946, entered upon his duties in said office on February 26, 1946, and is now lawfully acting as Administrator of the Office of Price Administration. There is substantial need of continuing and maintaining this action by him as successor in office to Chester Bowles as Administrator of the Office of Price Administration, for the reason that this action relates to the present and future discharge of the Office of Administrator of the Office of Price Administration, and is important in the administration and enforcement of the Emergency Price Control Act, as amended.

Wherefore, Paul A. Porter, as Administrator of the Office of Price Administration, moves for leave to be substituted as a party in the place and stead of Chester Bowles under authority of Rule 25(d) of Federal Rules of Civil Procedure.

Dated this 18th day of March, 1946.

/s/ JOE S. PEARSON

/s/ DANIEL M. REAUGH

Attorneys for the Administrator

[Endorsed]: Filed Mar. 30, 1946. [11]

[Title of District Court and Cause.]

ORDER FOR SUBSTITUTION

This matter having come on regularly for hearing this day before the undersigned, one of the Judges of the above entitled court, and it appearing to the court that Chester Bowes, plaintiff, a party in this action, has resigned from the Office of Price Administrator, of the Office of Price Administration effective February 26, 1946; that his resignation was duly accepted and that said Paul A. Porter entered upon the duties of said office on February 26, 1946, and is now lawfully acting as Administrator of the Office of Price Administration; that there is substantial need of continuing and maintaining this cause by him as successor in office to Chester Bowles as Administrator of the Office of Price Administration for the reason that this action relates to the present and future discharge of the office of Administrator of the Office of Price Administration and is important in the administration and enforcement of the Emergency Price Control Act; that good and sufficient notice

of the plaintiff's motion for substitution has been given to all interested parties, and the court being fully advised in the premises, now therefore, it is

Ordered, that Paul A. Porter, Administrator of the Office of Price Administration, is substituted as plaintiff in this action in the place and stead of Chester Bowles.

Done in open court this 6th day of April, 1946.

JOHN C. BOWEN

Judge

Presented by: JOE S. PEARSON

[Endorsed]: Filed April 6, 1946. [12]

[Title of District Court and Cause.]

STIPULATION

The parties hereto, by their respective counsel, hereby stipulate and agree as follows:

Whereas, plaintiff has filed in the above entitled court under Section 205(a), 205(c) of the Emergency Price Control Act of 1942, as amended, a complaint alleging therein that the above named defendants have violated Revised Maximum Price Regulation 330, as amended, issued pursuant to said Act and seeking judgment for treble damages; and

Whereas, it has been determined by the plaintiff and the defendants that the alleged overcharges,

if any, amount to \$714.01, and that said overcharges, if any, were not wilfully made or made through failure to exercise due precautions; and

Now Therefore, It Is Hereby Stipulated and Agreed by and Between the Parties Hereto

1. That in the event the defendants are found to have made the said overcharges alleged herein in the amount of \$714.01, plaintiff shall ask for judgment in the sum not to exceed \$714.01.

In Witness Whereof, the undersigned have caused their hands to be affixed the 12th day of April, 1946, at the City [13] of Seattle, Washington.

/s/ FREDERICK W. POST

/s/ DANIEL M. REAUGH

Enforcement Attorneys

Attorneys for Plaintiff

MERRITT, SUMMERS,

BUCEY, STAFFORD

By MATTHEW STAFFORD

Attorneys for Defendant.

[Endorsed]: Filed April 12, 1946. [14]

[Title of District Court and Cause.]

MOTION FOR JUDGMENT ON THE
PLEADING

Now comes the plaintiff by his attorneys and moves this court for Judgment on the Pleadings

under the provisions of Rule 12(c), for the reason that the affirmative defense set up in defendants' answer is insufficient in law to constitute a defense to plaintiff's complaint.

/s/ FREDERICK W. POST
Enforcement Attorney

/s/ DANIEL M. REAUGH
District Enforcement Attorney
Attorneys for Plaintiff

NOTICE

Defendant will take notice that the foregoing motion for judgment on the pleadings will come on for hearing before Judge Bowen on April 29, at 10:00 A. M. or at such time thereafter as the court may designate.

/s/ FREDERICK W. POST
Enforcement Attorney

Service of the foregoing notice acknowledged this 25 day of April, 1946.

MERRITT, SUMMERS
& BUCEY

By M. W. WILSON
Attorney for Defendant

[Endorsed]: Filed April 26, 1946. [15]

[Title of District Court and Cause.]

ORDER DENYING MOTION OF PLAINTIFF
FOR JUDGMENT ON THE PLEADINGS

This matter having come on before the undersigned judge of the above-entitled court on April 29, 1946, on motion of plaintiff for judgment on the pleadings; plaintiff being represented by Frederick W. Post, Enforcement Attorney of the Office of Price Administration of the United States of America, defendants being represented by Merritt, Summers, Bucey & Stafford, Matthew Stafford of counsel; and the court having considered said motion, the pleadings to which it was addressed, the brief in support thereof, and the memorandum in opposition thereto, and having heard argument of counsel, and being otherwise fully advised in the premises; Therefore

It is hereby Ordered that plaintiff's motion for judgment on the pleadings heretofore filed herein be and it is hereby denied.

Exception is allowed to plaintiff.

Done in open court this 14th day of May, 1946.

JOHN C. BOWEN

Judge.

Presented by: Merritt, Summers, Bucey & Stafford, By Matthew Stafford.

Approved as to form:

Enforcement Attorney of the Office of Price
Administration of the U. S. A.

Copy received 14 May 1946.

FREDERICK W. POST

[Endorsed]: Filed May 14, 1946. [16]

[Title of District Court and Cause.]

STIPULATION AS TO FACTS

Plaintiff and defendants herein hereby make and enter into the following stipulation as to agreed facts for use hereafter throughout this proceeding:

I.

The stipulation heretofore entered into herein under date of April 12, 1946, is by this reference made a part hereof as fully as though set out herein verbatim.

II.

All allegations contained in paragraphs I, II, III, IV, V, VI, VII, VIII and IX of defendants' further answer and affirmative defense heretofore filed herein are admitted by plaintiff to be true except the following portion of paragraph IV thereof:

"That said Reed C. Mills and said Ruth Sollie were duly authorized and empowered representatives of plaintiff and were acting within the scope of their authority in sending these communications to defendants."

III.

It is the purpose of this stipulation to limit the issues for trial in this case to the questions whether or not Reed C. Mills, District Price Executive, and Ruth Sollie, Apparel Section, of the Seattle Office of Price Administration, acted within the scope of their authority in sending to defendants the communications of September 14, 1944, and October 7, 1944, which [17] are set out verbatim in paragraph IV of the further answer and affirmative defense on page 2 and 3 of the answer of defendants heretofore filed herein, and whether defendants were required to comply literally with the instructions contained in those communications or whether defendants were justified in complying with those instructions, and whether the defendants' compliance with those instructions constitutes a defense to this action.

Done at Seattle, Washington, this 7th day of May, 1946.

/s/ FREDERICK W. POST

/s/ DANIEL M. REAUGH

Enforcement Attorneys

Attorneys for Plaintiff

DOROTHY HANSCOM et al,

Defendant

MERRITT, SUMMERS,

BUCEY & STAFFORD

By G. H. BUCEY

Attorneys for Defendant

[Endorsed]: Filed May 10, 1946. [18]

In the District Court of the United States for the
Western District of Washington, Northern
Division.

Civil Action No. 1446

PAUL A. PORTER, Administrator, Office of Price
Administration,

Plaintiff,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d.b.a. DOROTHY HANSCOM'S, a co-partner-
ship,

Defendants.

JUDGMENT

This matter having come on for trial duly and regularly before the undersigned judge of the above-entitled court on May 14, 1946, plaintiff appearing by Frederick W. Post, defendant R. C. Hanscom appearing in person and by Merritt, Summers, Bucey & Stafford, Matthew Stafford of counsel; the court having heard testimony of witnesses given in person and by deposition and having received documentary evidence, and having heard argument of counsel, and being otherwise fully advised in the premises;

The court finds that the actions of defendants and each of them of which plaintiff complains in this action were solely and directly caused by orders given to defendants by plaintiff, and that

plaintiff is estopped from maintaining this action; the court further finds that plaintiff has failed to prove any violation of any statute of the United States or regulation thereunder as alleged in the complaint herein.

Therefore, it is Ordered, Adjudged and Decreed that the complaint of the plaintiff herein be and it is hereby dismissed with prejudice and without costs.

Done in open court this 17th day of May, 1946.

JOHN C. BOWEN

Judge. [19]

Presented by:

MERRITT, SUMMERS,

BUCEY & STAFFORD

By MATTHEW STAFFORD,

Attorneys for Defendants.

Approved as to form:

FREDERICK W. POST

Enforcement Attorney for the Office of Price
Administration of the U. S. A. at Seattle,
Washington.

[Endorsed]: Filed May 17, 1946. [20]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Paul A. Porter, the Administrator of the Office of Price Administration, the plaintiff above named, hereby appeals to the Circuit Court of Appeals for the 9th Circuit

from the final judgment entered in this action on May 17, 1946.

/s/ FREDERICK W. POST,
Enforcement Attorney.

/s/ DANIEL M. REAUGH,
District Enforcement Attorney
Attorneys for Plaintiff.

Copy received Aug. 6, 1946. Merritt, Summers & Bucey, Attorneys.

[Endorsed]: Filed Aug. 7, 1946. [21]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL.

To the Clerk of the above entitled court:

Please prepare and transmit to the Circuit Court of Appeals for the Ninth Circuit, a record of the following pleadings and documents in the above entitled cause:

1. Complaint for Treble Damages.
2. Answer.
3. Motion to Substitute.
4. Order of Substitution.
5. Stipulation.
6. Motion for judgment on the pleadings.

7. Stipulation as to Facts.
8. Decision of District Judge.
9. Judgment.
10. Notice of Appeal.
11. Reporters Transcript of Testimony.

FREDERICK W. POST,
Enforcement Attorney

DANIEL M. REAUGH,
District Enforcement Attorney
Attorneys for Plaintiff.

Copy Received Aug. 14, 1946. Merritt, Summers
& Bucey, Attorneys.

[Endorsed]: Filed Aug. 14, 1946. [22]

[Title of District Court and Cause.]

STATEMENT OF POINTS TO BE RELIED
ON UPON APPEAL

Appellant, Paul A. Porter, Administrator, Office of Price Administration, will urge and rely upon the following points on the appeal taken by him in this cause:

1. The Court erred in finding that the actions of defendants and each of them were solely and directly caused by orders given to the defendants by plaintiff.

2. The Court erred in holding that plaintiff is estopped from maintaining this action.

3. The Court erred in finding that the plaintiff had failed to prove any violation of any statute of the United States or regulation thereunder as alleged in the complaint.

4. The Court erred in dismissing plaintiff's complaint with prejudice.

5. The Court erred in denying plaintiff's motion for judgment on the pleadings. [22-a]

6. The Court erred in failing to find that defendants had violated the Emergency Price Control Act and Revised Maximum Price Regulation 330, issued thereunder.

7. The Court erred in failing to enter judgment for plaintiff and against the defendants in the sum of \$714.01.

/s/ GEORGE MONCHARSH,
Deputy Administrator for
Enforcement.

/s/ DAVID LONDON,
Director, Litigation Division.

/s/ ALBERT M. DREYER,
Chief, Appellate Branch.

/s/ ABRAHAM MALLER,
Special Appellate Attorney.
Office of Price Administration
Washington 25, D. C.

/s/ DANIEL M. REAUGH,
District Enforcement Attorney.

/s/ FREDERICK W. POST,
Enforcement Attorney.
Office of Price Administration
Seattle, Washington

Copy received Aug. 30, 1946. Merritt, Summers
& Bucey, Attorneys.

[Endorsed]: Filed Aug. 29, 1946. [22-b]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRAN-
SCRIPT OF RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that the foregoing typewritten transcript of record, consisting of pages numbered from 1 to 22, inclusive, is a full, true and complete copy of so much of the record, papers and other proceeding in the above entitled cause as is required by praecipe of counsel filed and shown herein, as the same remain of record and on file in the office of the Clerk of said District Court at Seattle, and that the same, together with the reporter's transcript of testimony and proceedings transmitted as a part hereof constitute the record on appeal herein from the judgment of said

United States District Court for the Western District of Washington to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office by or on behalf of the appellant for making record, certificate or return to the United States Circuit Court of Appeals for the Ninth [23] Circuit, to wit:

Clerk's fees for making record, certificate or return:

17 pages at 40c	\$ 6.80
4 pages at 10c (copies furnished)40
Appeal fee	5.00
<hr/>	
Total	\$12.20

I further certify that the foregoing fees have not been paid to me for the reason that the appeal is being prosecuted on behalf of the Government.

In Witness Whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle, in said District, this 27th day of August, 1946.

(Seal) MILLARD P. THOMAS,
Clerk.

By /s/ TRUMAN EGGER,
Chief Deputy. [24]

In the District Court of the United States
For the Western District of Washington
Northern Division

No. 1446.

PAUL A. PORTER, Administrator,
Office of Price Administration,
Plaintiff,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d.b.a. DOROTHY HANSCOM'S, a
co-partnership,
Defendants.

Before the Honorable John C. Bowen, District
Judge.

Appearances: Frederick W. Post, Esq., Office
of Price Administration, Enforcement Attorney,
appearing for the Plaintiff;

Matthew Stafford, Esq., appearing for the de-
fendants.

Whereupon, the following proceedings were had
and done, to-wit: [1*]

* Page numbering appearing at top of page of original Reporter's
Transcript.

Seattle, Washington
May 14, 1946, 10:30 a.m.

PROCEEDINGS

The Court: Are the parties and counsel ready to proceed with the trial of Paul A. Porter, Administrator, Office of Price Administration, Plaintiff, versus Dorothy Hanscom and R. C. Hanscom, doing business as Dorothy Hanscom's, a co-partnership, defendants?

Mr. Stafford: Before we go into the trial, I should like——

The Court: Counsel may retain their present stations.

Mr. Stafford: I should like to present at this time an Order embodying Your Honor's ruling on the motion of the Plaintiff for judgment on the pleadings.

I might mention that counsel for plaintiff does not approve the form of this Order.

Mr. Post: If Your Honor please, the Order, I believe, goes farther than the Court's ruling.

The Court: Do you have a proposed order that does carry into effect the Court's ruling?

Mr. Post: No, I have not, Your Honor. The [2] Court heard the matter and overruled the plaintiff's motion. That is all I wish it to contain. The defendant here states more than the Court ruled. I believe he includes in here more than the Court actually ruled.

The Court: What words are more than the Court ruled?

Mr. Post: The Court found as follows: The Court found that the affirmative defense set up was sufficient in law to constitute a defense to it. I submit that the Court merely ruled that and made no finding as to the legal effect of the defendant's allegations as to the affirmative defense.

Mr. Stafford: I would like to be heard on that, your Honor.

The Court: Yes, you may be heard.

Mr. Stafford: If your Honor please, the sole basis for plaintiff's motion was that the affirmative portion of the defendant's Answer did not constitute in law a defense to the action. For that reason the plaintiff moved for judgment on the pleadings. I believe that it is impossible to deny the motion without finding that the matter did constitute a legal defense to the action. If it didn't constitute a defense to it, then your Honor must have allowed the [3] motion. That is the only——

The Court: Mr. Clerk, have you any minutes on this?

The Clerk: Yes, your Honor, but I do not have them here.

The Court: Bring them up, will you, or send down for them?

We will wait a moment.

Now, do you gentlemen have anything else to say?

Mr. Stafford: I have this to say, your Honor, that if it is Mr. Post's or your Honor's impression that I have maintained that there was any specific ruling by your Honor in so many words, I do not

maintain that at all. I drew this Order based on the language of the motion and on your Honor's ruling. As I say, I think it is not possible to deny the motion without making that finding, but I do not really care whether that finding is in there or not.

The Court: I think that what the Court had in mind I could tell better after hearing the evidence, so I am eliminating those words.

Mr. Stafford: I have no objection.

The Court: Lines 19 to 21, these words: "The Court found that the affirmative defense set up in Defendants' Answer was sufficient in law to constitute [4] a defense to Plaintiff's Complaint." Eliminate those words.

Let this Order be now entered.

You may proceed with the Plaintiff's opening statement.

OPENING STATEMENT PRESENTED BY ATTORNEY FOR THE PLAINTIFF

Mr. Post: The Plaintiff rests at this point.

The Court: You don't wish to go forward with any evidence; you do not wish to put on any evidence?

Mr. Post: No, your Honor.

The Court: The Defendant may now proceed.

Mr. Stafford: I regard it as necessary, if your Honor please, to review in my own way the situation as it now exists before any evidence is put in.

The Court: You may do that by saying to the Court at this time what you think the proof will

show. We will hear the argument on the merits later.

Mr. Stafford: Well, before I go into that, if your Honor please, I want to be very certain——

The Court: I just wish you to make an opening statement. That is all the Court will hear at this time, an opening statement of what you think the proof [5] will show.

OPENING STATEMENT PRESENTED BY
ATTORNEY FOR THE DEFENDANTS

Mr. Stafford: * * * Now, if your Honor please, there is, or should be in the file in this case a deposition of Mr. Irvin A. Hoff, which I would like to have published at this time.

The Court: Is there any objection?

Mr. Post: No objection, your Honor.

The Court: It is now published.

Do counsel agree that the Court may discard the jacket?

Mr. Post: Yes, your Honor.

Mr. Stafford: Yes, your Honor.

The Court: That is discarded and thrown away.

Let Counsel have that deposition. It is now published.

You may proceed to read it, if you wish to do so now.

Mr. Stafford: Is it agreeable, Counsel, if I omit reading the preamble?

Mr. Post: Yes. [6]

Mr. Stafford: This is the deposition of Irvin A. Hoff, which was taken on May 10, 1946 at

2:30 p.m., at the District Office of the Office of Price Administration, Enforcement Division, 3312 White Building, in the city of Seattle, County of King, State of Washington, before Walter R. Groshong, Notary Public in and for the State of Washington; the Plaintiff appearing by Frederick W. Post, Esq., Enforcement Attorney, who is now in attendance at this trial; the Defendants were represented by myself.

I shall proceed directly to the reading of Mr. Hoff's testimony which begins on page 3 of the deposition.

(Reading.)

IRVIN A. HOFF

called as an adverse witness on behalf of the Defendants, having been first duly sworn, deposed and said as follows:

Direct Examination

“By Mr. Stafford:

“Q. Would you state your name, please?

“A. Irvin A. Hoff.

“Q. Are you employed by the Office of Price Administration of the United States of America?

“A. Yes.

“Q. In what capacity, Mr. Hoff? [7]

“A. As District Director of the Seattle District.

“Q. Who would be your immediate superior in the Office of Price Administration organization?

(Deposition of Irvin A. Hoff.)

“A. Mr. Ben C. Duniway, Regional Administrator.

“Q. Where is his office located?

“A. San Francisco, California.

“Q. So that as far as the Seattle District is concerned, you are the ranking official in that District? A. Yes.

“Q. Who was Director of the Seattle District of the Office of Price Administration during the months of September and October, 1944, Mr. Hoff?

“A. Arthur J. Krauss, of this city.

“Q. Was the position occupied by Mr. Krauss in all substantial particulars the same as the position now occupied by you? A. Yes.

“Q. Have you ever had as a subordinate Mr. H. C. Mills?”

Mr. Stafford: That is obviously an error there. It should read “Mr. Reed C. Mills.” Is that agreeable to Counsel?

Mr. Post: Yes, Reed C. Mills.

Mr. Stafford (Continues reading of deposition):

“A. From August 15, 1945, until March, 1946, he was [8] a subordinate.

“Q. Of yours? A. Of mine.

“Q. In what capacity, Mr. Hoff?

“A. As District Price Executive.

“Q. Do you know whether or not Mr. Mills occupied the position of District Price Executive under Mr. Krauss in the Seattle District Office during the months of September and October, 1944?

“A. Yes, I know that he did.

(Deposition of Irvin A. Hoff.)

“Q. Do you know, Mr. Hoff, whether or not there were in existence during and prior to the months of September and October, 1944, any written definition or limitation of the authority which Mr. Mills, as District Price Executive, could exercise on behalf of the Office of Price Administration? A. Yes.

“Q. What writings constituted that definition or limitation of his authority, Mr. Hoff?

“A. First, there is Revised Procedural Regulation No. 1, including Amendments 1 to 9,—

“Q. Of the Office of Price Administration?

“A. Of the Office of Price Administration. (Continuing) —issued on August 26, 1944, and, second, [9] a job description approved by the Civil Service Commission on October 9, 1943, which set forth in broad terms his responsibilities.

“Q. Are there any others?

“A. In addition his own specific job description set up under the standards provided by Civil Service, containing limitations on his authority.

“Q. Is that available here today?

“A. It is not.

“Q. Is his own specific job description available today? A. No.

“Q. Where would that be found?

“A. It is in the Personnel Section of the Regional Office in San Francisco.

“Q. Has it ever been a part of the records of the Seattle Office as far as you know?

“A. Yes, it has.

(Deposition of Irvin A. Hoff.)

“Q. Why is it no longer a part of the records of the Seattle District Office?

“A. It normally would be. In this specific case the job description was either sent to the Regional Office for examination or our own copy is misplaced.

“Q. Do these three documents, then, constitute the [10] sole written definition or limitation of the authority of the District Price Executive? By ‘these three,’ of course, I refer to Revised Procedural Regulation No. 1, the general Civil Service job description and the specific job description which you have just mentioned.

“A. To the best of my knowledge, yes.

“Q. Has it been the practice of the Office of Price Administration, particularly of the Seattle District, to grant or limit authority of the District Price Executive by oral communication from his superior or superiors?

“A. There have been times when Mr. Mills, or the Price Executive, if you wish to put it that way, has been delegated authority to act as Acting District Director in the absence of the District Director, to assist in informational activities, but the District Director, to whom the Price Executive is directly responsible, has no authority to delegate to Mr. Mills responsibilities for action outside that contained in his job description and in Procedural Regulation No. 1.

“Q. Who, then, would confer upon Mr. Mills authority to act as Acting District Director? [11]

(Deposition of Irvin A. Hoff.)

“A. The District Director has that authority.

“Q. Is there any record in this office from which can be established the exact periods during which Mr. Mills acted as Acting District Director?

“A. Yes.

“Q. Do you have those records before you?

“A. I have them available right here.

“Q. All right, it will be very helpful if you will break them out. We can pass that for a minute. We will pass that for a moment, Mr. Hoff, and go to something else.

“Now, taking up the first of the writings you have mentioned as constituting definitions of the District Price Executive's authority, do you have an extra copy of that?

“A. I think we can get one to include in the record.

“Mr. Stafford: That is what I was thinking we would do. Let the record show that a copy of Revised Procedural Regulation Number 1 has been marked as Defendants' Exhibit 1.

“(Whereupon, copy of Revised Procedural Regulation No. 1, Office of Price Administration, dated August 26, 1944, was marked Defendants' Exhibit 1 for identification, is attached hereto and forwarded herewith.) [12]

“Q. (By Mr. Stafford): Referring to Defendants' Exhibit No. 1, Mr. Hoff, I will ask you to state if you know what that is.

“A. Yes.

“Q. What is it?

(Deposition of Irvin A. Hoff.)

“A. That is a regulation put out by the——

“Q. No, I mean the title.

“A. Revised Procedural Regulation No. 1.

“Q. Of the Office of Price Administration?

“A. Of the Office of Price Administration.

“Q. Now I should like to ask you to refer to such portion or portions of that Regulation, Mr. Hoff, as you claim or believe to constitute the definition of the authority of the District Price Executive.

“A. Sections 54 and 55 of Procedural Regulation No. 1.

“Q. Now referring to Section 54 of Procedural Regulation No. 1, which constitutes Defendants' Exhibit No. 1 in this case, I shall call your attention to this language, which occurs in the opening sentence of that Section,

“‘An interpretation rendered by an officer or employee of the Office of Price Administration with respect to any provision of the Act or of any regulation, price schedule, order, requirement, [13] or agreement thereunder * * *.’ I would like to ask you to state, if you know, what is the meaning of the word ‘order’ in that sentence.

“A. My belief is that the word ‘order’ refers to pricing orders issued by a National, Regional or District office setting prices for a particular office setting prices for a particular firm as a result of application by that firm for an adjustment in prices.

(Deposition of Irvin A. Hoff.)

“Q. Is that the only kind of order that the Office of Price Administration can issue?

“A. I am not sure on that point.

“Q. Is it not a fact, Mr. Hoff, that the Office of Price Administration issues orders of different kinds than the one you have just described?

“A. In our own official language within the agency an ‘order’ to the best of my knowledge refers to a pricing order. We do issue instructions to the trade, but again within the official language of the agency those would not be considered orders.

“Q. Refer now, Mr. Hoff, to Section 64 of PR-1, a copy of which constitutes Defendants’ Exhibit 1, in this case. If you have it before you, you will note that that Section deals with definitions [14] as used in this Revised Procedural Regulation. You will find there ten terms defined. After looking it over will you state whether or not you find any special definition for the word ‘order’?

“A. I do not.

“Q. Do you find therein any special definition of the word ‘requirement’? A. No.

“Q. Now refer to Paragraph (d) of Section 64 of Defendants’ Exhibit 1 and I will ask you if you do not find this language,

“‘Maximum price regulation means any regulation or order establishing a maximum price or prices.’

“That language occurs? A. Yes.

“Q. Does not that language suggest to you that an order establishing a maximum price or prices

(Deposition of Irvin A. Hoff.)

is only one type or order and that that is the only type that is brought within the definition of 'maximum price regulation'? You don't need to answer that question. That will be a matter for the Court to decide.

"Now referring back to Section 54, Mr. Hoff, [15] I will call your particular attention to the word 'requirement' which occurs in the first sentence of that Section. What is your understanding of the word 'requirement' as used in that Section?

"A. To my mind that refers to the Emergency Price Control Act under which the Office of Price Administration operates.

"Q. If your understanding is correct, then why does the word "Act" appear in the immediate preceding line?

"A. Because the subject of this Section deals with interpretations of regulations, price schedules, orders or requirements under the Act.

"Q. Does not that statement by you concede, then, Mr. Hoff, that orders and requirements are made under the Act which exists separately from the Act? A. Yes.

"Q. Who issues such orders and who pronounces such requirements on behalf of the Office of Price Administration?

"A. Orders, regulations——

"Q. No, just orders and requirements.

"A. All right. Orders and requirements are issued [16] in the name of the Administrator nationally, the Regional Administrator regionally or

(Deposition of Irvin A. Hoff.)

the District Director locally, limited by the authority that each possesses.

“Q. Are any orders or requirements issued or pronounced by anyone else except the Administrator, the Regional Administrator or the District Director?

“A. Not within my understanding of the terms ‘orders’ and ‘requirements.’ I must qualify that by saying in the absence of the Administrator, Regional Administrator or District Director, the individual designated to act in his absence would possess the same authority.

“Q. Now, can you produce any document, Mr. Hoff, which says that no one but the Administrator, the Regional Administrator or District Director can issue an order or pronounce a requirement under this Act?

“A. The only evidence I have of that fact as concerns my own position as District Director is contained in the OPA Manual, Chapter 1-102, titled ‘District Offices,’ a chapter which outlines the authority of the District Director.

In Section 1-10202 of this chapter, Subsection [17] .04, the following statement appears, referring to the District Director,

‘Shall sign all documents requiring official signature with his name and title.’

“Q. And that constitutes the only written evidence of what you believe to be the limitation on the authority of anyone to sign or to issue orders for the Office of Price Administration?

(Deposition of Irvin A. Hoff.)

“A. The only evidence of which I have knowledge.

“Q. Now referring again to Section 54 of Procedural Regulation No. 1, a copy of which constitutes Defendants’ Exhibit No. 1 in this case, I will ask you to state, Mr. Hoff, if it isn’t your reading of the first sentence of that paragraph or section that it deals with the interpretations of any provision of the Act, or of any regulation, price schedule, order, requirement, or agreement thereunder, and that therefore the regulation, price schedule, order, requirement or agreement must exist separately from the Act and separately from the interpretation discussed here? A. Yes.

“Q. Referring now to Section 1 of Revised Procedural Regulation No. 1, on the first page, does that section not state that it is the purpose of this [18] regulation to prescribe and explain the procedure used by the Office of Price Administration in making various kinds of price determinations? That sentence, of course, occurs there, does it not?

“A. Yes.

“Q. So that the express purpose of this Procedural Regulation has to do solely with the procedure used by the Office of Price Administration in making price determinations?

“A. That is right.

“Q. Now, is the matter of filing a pricing chart the making of a price determination?

“A. No, not in my mind.

“Q. Getting back to the question of the author-

(Deposition of Irvin A. Hoff.)

ity of the District Price Executive, may I see the second document which you have described, which you described generally as the general job description issued by the United States Civil Service Commission? I should like to ask you, Mr. Hoff, in connection with this document whether or not the Seattle District Office of the Office of Price Administration is a Class A Office of Price Administration District Office? A. It is. [19]

“Q. And was it during the entire period of 1944? A. Yes.

“(Whereupon, Office of Price Administration release of United States Civil Service Commission job description of ‘District Price Officer’ was marked Defendants’ Exhibit No. 2 for identification, is attached hereto and forwarded herewith.)

“Q. (By Mr. Stafford): Handing you Defendants’ Exhibit 2, Mr. Hoff, I will ask you to state, simply for the purpose of identification, whether or not that is the second of the two documents to which you referred earlier in your testimony as constituting the written definition of the authority of the District Price Executive? A. Yes.

“Mr. Stafford: I should like to have that admitted in evidence in this record, Mr. Post.

“Mr. Post: I have no objection to the admission of that document.

“Q. (By Mr. Stafford): Now, the third document to which you referred as constituting a definition of the authority of the District Price Execu-

(Deposition of Irvin A. Hoff.)

tive, Mr. Hoff, is the substance of that document set forth on the chart which now appears on your desk? A. Yes. [20]

“Q. Is the substance of that document set forth in that District in the following language:

‘Office of the Price Executive. Responsible for direction and operation of District Price Division, subject to administrative supervision of the District Director and technical direction of the Regional Price Executive.

‘Establishes operating policies of the District Price Division, consistent with those of the National and Regional Offices.

‘Charged with securing trade and public understanding of and compliance with price regulations and orders.

‘Acts in cooperation with other appropriate divisions, to insure issuance of uniform information and interpretation by local boards and appropriate actions in retail violation cases.

‘Directs through appropriate price sections, collection of information relation to supply, flow and distribution of commodities and maximum recommendations for orders or amendments affecting commodities subject to price control. [21]

‘Selects, allocates duties, trains and supervises division staff, through the appropriate section heads.

‘Responsible through designated channels, for directing administrative functions essential to effective operation of the division.

(Deposition of Irvin A. Hoff.)

'Provides for handling new, enlarged or altered programs through reassignment of staff duties, increased personnel or activity priority schedules.

'Prepares and reviews statistical data and reports required by District Director or through regional office.

'Acts as representative for the District Director or Regional Price Executive when requested.'

"A. Yes.

"Q. In a District Office of the Office of Price Administration, Mr. Hoff, is it not a fact that the District Price Executive is, under the District Director, the key executive, or the most important executive? Put it that way.

"A. In administering the affairs of price control, yes. He is supplemented, however, by other [22] division heads who have co-status with him.

"Q. What are the other division head positions?

"A. District Enforcement Attorney, District Rent Executive, District Board Executive and District Information Executive. However, all of those programs revolve around the price program.

"Q. And the heart of the whole program being the price program, the Price Executive would be in what might be properly termed the key position in the organization under the District Director?

"A. That is right.

"Q. And that is the position occupied by Mr. Mills during the months of September and October, 1944?

A. Yes.

"Q. Would it be proper to say that there was

(Deposition of Irvin A. Hoff.)

no District Officer or representative of the Office of Price Administration in the Seattle District who would be regarded as a superior to Mr. Mills during that period other than the District Director? A. Yes.

“Q. Does the District Director ever directly personally [23] concern himself in the administration of the Act or any regulation, order or requirement under the Act in the sense that he deals directly with the members of the trade who are subject to the Act?

“A. On occasions, yes.

“Q. Usually does he? A. Usually, no.

“Q. Usually is it not a fact that in dealing with any wholesaler, manufacturer or retailer that the direct contact with the manufacturer, wholesaler or retailer would be through the Price Executive?

“A. Through the Price Executive or one of his section heads.

“Q. Is it not a fact that it is one of the duties of the Price Executive, either acting in person or through one of his section heads, to instruct the trade and see to it that the pricing program is carried out by the trade? A. Yes.

“Q. And was that not one of his duties during the months of September and October, 1944?

“A. Yes.

“Q. Was Ruth Sollie one of the section heads under [24] Mr. Mills as District Price Executive during the months of September and October, 1944?

“A. It is my recollection, Mr. Stafford, that she

(Deposition of Irvin A. Hoff.)

wasn't a section head but she was a member of the Apparel Section.

“Q. Would it be one of the duties of Ruth Sollie, as a member of the Apparel Section under Mr. Mills, District Price Executive, to send out a communication to a member of the trade bearing the signature, ‘Reed C. Mills, Price Executive, by Ruth Sollie, Apparel Section’? A. Yes.

“Q. And to all practical intents and purposes that would constitute the signature of Mr. Mills, would it not? A. Yes.

“Q. Mr. Hoff, earlier in your testimony you mentioned that on occasion the District Price Executive acts as Acting District Director, particularly in the absence for more than one business day of the District Director from the District Office. Is that a fact? A. Yes.

“Q. To your knowledge did Mr. Mills act as Acting Director at various times during his occupancy [25] of the office of District Price Executive? A. Yes.

“Q. Can you state during what periods he did so act during the year 1944? A. No.

“Q. Is the record at this time available which would show the periods during 1944 when he did so act? A. No.

“Q. During the periods when he did so act would he be vested with the authority of the District Director? A. Yes.

“Mr. Staffoffrd: That is all.”

(Deposition of Irvin A. Hoff.)

Mr. Stafford: Mr. Post, you may now read the cross-examination of this deposition.

(Thereupon, Mr. Post read the cross-examination of the deposition of Mr. Hoff.)

Cross Examination

“By Mr. Post:

“Q. Does the District Price Executive have authority in his official capacity to interpret [26] regulations issued pursuant to the Emergency Price Control Act?

“A. No. That authority is reserved to the Price Attorney.

“Q. Is there a procedure by which interpretations of regulations issued pursuant to the Emergency Price Control Act may be obtained?

“A. Yes.

“Q. Where does that procedure appear?

“A. In Revised Procedural Regulation No. 1, Sections 54 and 55.

“Q. To your knowledge is there any provision other than Revised Procedural Regulation No. 1 by which the District Price Executive might render an interpretation of a regulation issued pursuant to the Emergency Price Control Act which would be binding upon the Office of Price Administration? A. No.

“Mr. Post: That is all I have.

“(Witness excused.)” [27]

Mr. Stafford: Now, if your Honor please, be-

fore I go on to the next question I think it would be well for me to read that exhibit which has already been pointed out.

The Court: Has it been admitted in evidence?

Mr. Stafford: No.

The Court: Will a stipulation cover it?

Mr. Stafford: Well——

Mr. Post: That is Exhibit Number 2?

Mr. Stafford: Yes.

I think, Mr. Post, you will agree at this time—— will you agree that Exhibits 1 and 2 may be admitted in evidence at this time?

Mr. Post: Yes.

The Court: Detach them from that deposition and let the Clerk have them for the purpose of identifying them with proper markings.

Mr. Stafford: Is it agreeable to the Court to have exhibits marked according to the same system——

The Court: No, they will be marked according to the Court system.

Mr. Stafford: Well, this would be Defendants' Exhibit A-1, and this one, Defendants' Exhibit A-2.

(Bulletin OPA (Rev. PR-1) marked for identification as Defendants' Exhibit A-1.) [28]

(Copy of pamphlet (District Price Officer) marked for identification as Defendants' Exhibit A-2.)

The Court: Each of them upon agreement between the parties is now admitted into evidence.

(The document heretofore marked Defend-

ants' Exhibit A-1 for identification was received in evidence.)

(The document heretofore marked Defendants' Exhibit A-2 for identification was received in evidence.)

The Court: At this point the Court will be at recess for ten minutes.

(Recess.)

The Court: You may proceed.

(Mr. Stafford continues with opening statement.)

Mr. Stafford: I would like to have Miss Sollie.

RUTH SOLLIE

called as a witness by and on behalf of the defendants, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Stafford:

Q. Would you state your name, Miss Sollie?

A. Ruth Sollie.

Q. During the months of September and October, 1944, Miss Sollie, were you employed by the Seattle office of the Office of Price Administration of the United States of America?

A. Yes, I was.

Q. In what capacity?

(Testimony of Ruth Sollie.)

A. At that time I believe I was a Price Aide in the Apparel Section.

(Office of Price Administration letter, dated September 14, 1944, marked Defendants' Exhibit A-3 for identification.)

(Office of Price Administration letter, dated October 7, 1944, marked Defendants' Exhibit A-4 for identification.)

Q. (By Mr. Stafford, continuing): Miss Sollie, I hand [30] you Defendants' Exhibit A-3. I shall ask you to state if you know what that is.

A. Yes, I do.

Q. What is it?

A. It's a letter that was sent out to retailers advising them of a new regulation being issued.

Q. Was that sent out by you?

A. Yes, it was.

Q. Under the direction of Mr. Mills?

A. It was sent out by our Division, yes.

Q. And Mr. Mills was the head of that Division?
A. Yes.

Q. And on behalf of Mr. Mills you signed it with Mr. Mills' signature?

A. No, it was my signature.

Q. Well, I mean, your signature appears as acting for him, does it not?
A. Yes, it does.

Q. Now, before that was sent out, Miss Sollie, to whom did you submit that for approval?

A. I don't remember this particular letter, who

(Testimony of Ruth Sollie.)

it was submitted to for approval. Whether it was submitted to anyone for approval I don't know.

Q. Normally, was it a fact, Miss Sollie, that you submitted all such letter to the Legal Division for an [31] opinion and approval before they went out?

A. I wouldn't say on this type of letter. On letters, for instance, like acknowledgments and letters of that sort, they were all approved by the Legal Department. But this particular letter was just a letter sent out to retailers reminding them of a new requirement in the Regulations.

Q. Who wrote this letter? A. I did.

Q. You wrote it? A. Yes.

Q. Did Mr. Mills ever see it?

A. Well, I don't remember whether he saw this particular letter, but I imagine he did.

Q. I see. And that would be before it went out? A. Yes.

Q. Now, calling your attention to Defendants' Exhibit A-4, is the testimony which you have just given regarding Defendants' Exhibit A-3 the same, —does it apply to Defendants' Exhibit A-4?

A. Yes.

Q. And both of those were sent out by you?

A. Yes.

Mr. Stafford: I have no further questions. [32]

Cross-Examination

By Mr. Post:

Q. Miss Sollie, how soon after the effective date of MPR-330 did copies of that Regulation become available to the trade?

(Testimony of Ruth Sollie.)

Mr. Stafford: If your Honor please, this is cross-examination. I covered no matter of that kind in my direct examination.

The Court: What have you to say with respect to the objection?

Mr. Post: Your Honor, it has been gone into. The exhibit which has been admitted there, it makes reference to the fact that the Revised Maximum Price Regulation 330 was not at that time available.

Now, I would like to bring out the fact through this witness who identified the exhibit whether or not the Regulation ever did become available. I submit that the matter is before the Court.

Mr. Stafford: If your Honor please, my inquiry of Miss Sollie did not at all refer to this. I simply asked her if she sent it out and if Mr. Mills saw it before it went out, and I assume——

The Court: The objection is sustained.

If you need this testimony, you may bring it out properly from the witness by calling her as your [33] witness in rebuttal. You would be given that opportunity.

Q. (By Mr. Post, continuing): What was the purpose of your letters of September 14, 1944 and October 7, 1944, which have been handed you by counsel for the defense?

Mr. Stafford: Just a moment, Miss Sollie.

If your Honor please, that again is not proper cross-examination and in addition to that the documents speak for themselves. What her individual purpose was has nothing to do with this case at all.

(Testimony of Ruth Sollie.)

The Court: The objection is sustained.

Mr. Post: I have no further questions, your Honor.

The Court: The Court again repeats, Mr. Post, if you wish to later recall this witness as a part of the Plaintiff's case in rebuttal, it would become appropriate to put on rebuttal testimony.

You may step down.

(Witness excused.)

Mr. Stafford: I would like to have Mr. Mills called. [34]

REED MILLS

called as a witness by and on behalf of the Defendants, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Stafford:

Q. Will you state your name, Mr. Mills?

A. Reed Mills.

Q. During the months of September and October, 1944, Mr. Mills, were you employed by the Office of Price Administration of the United States of America? A. Yes.

Q. In what capacity?

A. Price Executive.

Q. In which District Office?

A. The Seattle District.

(Testimony of Reed Mills.)

Q. You have, have you not, heard me read the deposition of Mr. Hoff and two of the documents which Mr. Hoff stated defined the authority of the District Price Executive; did you hear me read those? A. Yes.

Q. Did you hear that portion of Mr. Hoff's testimony in which he testified that the District Price Executive was the key executive in administering the pricing [35] program? A. Yes.

Q. Is that true? A. I believe so.

Q. And that is the position you occupied during the months of September and October, 1944?

A. Yes.

Mr. Stafford: I have no further questions.

Mr. Post: I have no questions, your Honor, either.

The Court: You may step down.

(Witness excused.)

The Court: Call your next witness.

Mr. Stafford: Mr. Hanscom.

ROBERT C. HANSCOM

called as a witness herein, being first duly sworn, testified as follows:

Direct Examination

By Mr. Stafford:

Q. Will you state your name, Mr. Hanscom?

A. Robert C. Hanscom.

Q. Are you one of the defendants in this case?

(Testimony of Robert C. Hanscom.)

A. Yes.

Q. Is the business establishment known as Dorothy Hanscom's, which is named in this case, the business establishment of yourself and Dorothy Hanscom, your wife? A. That is true.

Q. Is it a fact that this place of business was opened during the month of December, 1943, for the first time? A. Yes.

Q. At that time were you operating under a pricing chart which you obtained from Best's Incorporated here in Seattle? A. Yes.

Q. Now, after you had commenced doing business, Mr. Hanscom, did you sell any merchandise at prices lower than the ceiling fixed by the pricing chart which you obtained from Best's Incorporated- A. Yes, we did.

Q. Did you sell any items at prices in excess of the ceiling fixed by that pricing chart?

A. We did not.

Q. Did you continue the merchandising policy which you [37] have just described from December, 1943, through September, 1945?

A. Yes, we did.

Mr. Post: I will object to this line of questioning on the grounds that all of the facts have been set forth in the Answer and there——

Mr. Stafford: I was not at all satisfied that the pleading was sufficiently clear in respect to the proposition which I seek to prove by Mr. Hanscom, that the communications of September 14 and October 7, 1944, were relied upon by Mr.

(Testimony of Robert C. Hanscom.)

and Mrs. Hanscom, and as a result of that reliance the Hanscoms acted to their detriment in a manner which they would not have acted had they been properly advised at that time and it is for that purpose that I wish to offer this testimony.

The Court: The objection is overruled.

Q. (By Mr. Stafford, continuing): Now, Mr. Hanscom, during the year beginning January 22, 1944, 1945, I mean, the year beginning January 22, 1945, would the total amount of—strike that, Mr. Reporter.

During the year beginning January 2, 1945, would the sales of merchandise which you made in your establishment at Fifth and University here in Seattle at [38] prices under the ceiling fixed in the pricing chart which you adopted at the time you commenced doing business in December, 1943, would the amount which was received for those sales, would the amount which would be arrived by subtracting what was received for those sales from the ceiling prices which you could have charged for those sales exceed in the aggregate \$714.01?

A. I am sorry, I am not just quite clear on that question.

Q. Well, you have already testified that throughout the year 1945, you sold some merchandise at prices lower than ceilings fixed by the pricing chart which you adopted in December, 1943, and which you continued to use throughout 1945.

Now, I am asking you if you took the total amount which you received for those sales, those

(Testimony of Robert C. Hanscom.)

particular sales and subtracted it from the amount you would have received if you had made all of those sales at the ceilings, would the result of that subtraction exceed \$714.01?

A. Yes, it would.

Q. Now, is it a fact, Mr. Hanscom, that if you had sold all merchandise that was sold by you during the four months immediately succeeding the commencement of your business in December of 1943, at the ceilings fixed [39] in your pricing chart, if you had done that, would you have had any difficulty such as the difficulty which forms the basis of this case?

A. No, we wouldn't have any difficulty.

Q. So that the whole basis of this case is the fact that you sold under your pricing ceilings?

A. That is true.

Q. During the first four months of your business?

A. That is true.

Q. If you had been properly advised by the Office of Price Administration in September and October, 1944, with respect to the filing of charts, would you have continued the merchandising policy that you did pursue?

A. No, we wouldn't have.

Mr. Stafford: You may inquire.

Cross-Examination

By Mr. Post:

Q. Mr. Hanscom, you received a communication dated October 7, 1944, from the Office of Price Administration, is that correct?

(Testimony of Robert C. Hanscom.)

A. That is true.

Q. And it is stated therein that a copy of this Revised Regulation will be sent to you by your local OPA Board as soon as they received their supply. Did you [40] receive a copy of the Regulation?

A. We did eventually.

Q. And did you read it? A. Yes.

Q. You read it? A. Surely.

Q. And did you read the part that appears in Section 2, subsection C (1) which describes what your base period is?

A. I read the Regulation. I don't recall those numbers of that particular part.

Q. Do you know what provision the Regulation makes with reference to price charts to be filed by persons starting in business after October 1st, 1942, but before May 18, 1944?

A. Yes.

Q. What is that provisions?

A. Well, the provisions required that people starting in business will be given, will be offered a pricing chart by their nearest competitor and they should not charge higher than those prices given in the chart.

Q. I am speaking of Revised Maximum Price Regulation 330. You allege in your Answer that you did file a price chart, an amended price chart, in accordance with Revised Maximum Price Regulation 330. What was the basis for [41] that price chart?

A. The basis was the instructions we had from the Office of Price Administration.

(Testimony of Robert C. Hanscom.)

Q. What were those instructions?

A. To file the chart we had been operating under.

Q. You have a chart on file now with the Office of Price Administration? A. Yes.

Q. What is the basis for that chart?

A. As a matter of fact, we have two charts there.

Q. I beg your pardon?

A. We have two charts there.

Q. The one you filed last, what is the basis for the preparation of that chart?

A. It's based on our first four months of operation.

Q. And does the Revised Maximum Price Regulation provide, 330, does the Regulation provide that that was the price chart which you should have filed in October of 1944?

A. I believe it does.

Q. Now, then, you know that that price chart based on your first four months of business was the correct price chart. Why did you not file that price chart when Revised Maximum Price Regulation 330 came out?

A. Because we thought we had already done it according [42] to the instructions given to us by the Office of Price Administration.

Q. But you testified that you filed a price chart based on your nearest competitor in the first instance and not based on your first four months of business, is that correct?

(Testimony of Robert C. Hanscom.)

A. That is true.

Q. Now, then, is the reason that you did not file a price chart based on your first four months of business due to the fact that you received certain communications in writing from the Office of Price Administration?

A. I am not quite clear on that question.

Mr. Post: Will you read it back to him, Mr. Reporter?

(The reporter read the question as above recorded.)

Mr. Post: Do you understand the question?

The Witness: No, I do not.

Mr. Post: I will restate it.

Q. (By Mr. Post): Is the reason why you did not file the correct price chart due to the fact that you received certain communications from the Office of Price Administration in writing which led you to do something else? [43]

A. We just followed the instructions we had.

Q. In those written communications?

A. Yes.

Q. Now, then, how soon after your received those written communications did you receive a copy of the Regulation?

A. I couldn't tell you accurately. I don't know.

Q. Approximately?

A. I am sorry, I couldn't tell you because I don't know. I would say within a matter of weeks, but I wouldn't be able to tell you accurately.

(Testimony of Robert C. Hanscom.)

Q. A matter of weeks. Did you read the Regulation you received? A. Yes.

Q. And why, when you received it, did you not notice that the notice regulation provided that you file a price tariff (chart) based on your first four months of business rather than the price chart which you prepared and had in your place of business based upon your nearest competitor, Best's; why did you not notice that difference, that error?

A. We felt our original chart covered that.

Q. But you didn't read the Regulation to find out, did you?

Mr. Stafford: If your Honor please, I submit [44] that is arguing with the witness. He has already testified that he read the Regulation and that he thought the chart——

The Court: Objection overruled.

A. I did read the Regulation.

Q. But you did discover the error after you read the Regulation, isn't that correct?

A. That is true.

Q. Did you ever request in writing an interpretation of Revised Maximum Price Regulation 330 from the District Price Attorney?

A. No, we never did.

Mr. Stafford: We will admit that no such request was ever made by the defendants or either of them or anyone or by anyone on their behalf.

Mr. Post: I have no further questions, your Honor.

The Court: Any further questions?

(Testimony of Robert C. Hanscom.)

Mr. Stafford: If your Honor will give me a moment.

The Court: You may have a moment to consider. How much money is involved in the claim here?

Mr. Stafford: \$700.

The Court: \$700?

Mr. Stafford: \$714.01. I have no further [45] questions.

The Court: Is there anything further?

Mr. Post: I have nothing further.

The Court: You may be excused, Mr. Hanscom.
(Witness excused.)

Mr. Stafford: The Defendants have no further testimony to offer.

The Court: Any rebuttal?

Mr. Post: I would like to call Mr. Mills for one question.

The Court: Come forward, Mr. Mills.

REED MILLS

recalled as a witness herein, having been previously duly sworn, testified further as follows:

Recross Examination

By Mr. Post:

Q. Mr. Mills, I hand you Defendants' Exhibits A-3 and A-4 and ask you to identify the same.

A. Describe them, you mean?

Q. Yes, describe what they are. [46]

(Testimony of Reed Mills.)

A. Well, they are routine letters addressed to all of a certain type of trade advising them of the existence of a regulation and requesting compliance.

Q. What was the principal purpose of those communications?

Mr. Stafford: If your Honor please, that is calling for an opinion and conclusion from the witness. The documents speak for themselves.

The Court: What is there in dispute which makes interpretation necessary?

Mr. Post: It is merely appraisal evidence to explain a written instrument, your Honor.

The Court: I don't think that is necessary.

Mr. Post: I will withdraw the question, your Honor.

Questions by the Court:

Q. Mr. Mills, did you ever have any conference with Mr. Hanscom about the prices to be charged from time to time?

A. No, I don't believe so.

Q. Did you ever receive from him, or his wife, any written communication asking for an interpretation on prices or price schedules or regular price regulations as applied to their business?

A. Not to my knowledge. [47]

Q. Did you ever personally make any written interpretation to them of any regulation?

A. No, sir.

Mr. Post: I have nothing further, your Honor, from this witness.

(Testimony of Reed Mills.)

Mr. Stafford: I should like to ask Mr. Mills one question.

Redirect Examination

By Mr. Stafford:

Q. When you say to the Court that you did not in person make any communication to the Hanscoms, certainly you did not mean to suggest that the documents which now lie before you and which are marked Defendants' Exhibits A-3 and A-4 were not sent out as your communications fully as though you had signed them yourself; you don't mean to suggest that?

A. No. That is a letter sent over my signature. It is not a direct communication.

Q. But it is a communication precisely the same in force as if it had been written——

The Court: Is it addressed to any person or firm?

The Witness: No. It is addressed to All Dealers in Women's, Misses' and Children's Outerwear [48] Garments.

The Court: I do not recall any offer being made of either of those two exhibits, A-3 and A-4.

Mr. Stafford: I would like at this time to offer them in evidence.

The Court: Any objection?

Mr. Post: I have no objection, your Honor.

The Court: Each of them is admitted.

(The document heretofore marked Defendants' Exhibit A-3 for identification was received in evidence.)

(Testimony of Reed Mills.)

(The document heretofore marked Defendants' Exhibit A-4 for identification was received in evidence.)

The Court: If there are no further questions, Mr. Mills may now be excused.

Mr. Post: I have no further matters in rebuttal.

The Court: All right.

Each side rests, is that correct.

Mr. Stafford: Yes, your Honor.

The Court: I will hear your argument at 2:00 o'clock.

How long do you think you will need, Mr. Post, to present your side of the case in argument?

Mr. Post: I believe I would like to have twenty minutes.

The Court: How much would you like, Mr. Stafford?

Mr. Stafford: I would like at least a half hour.

The Court: All right. Each of you may have a half hour beginning at 2:00 o'clock.

Court is recessed until that time.

(At this point a recess was taken to 2:00 p.m., same day, United States Court House.) [50]

[Title of District Court and Cause.]

Seattle, Washington

May 14, 1946

2:00 p.m.

(All parties present as before.)

(Closing Argument Presented By Attorneys for the
Plaintiff and Defendants, Respectively.)

COURT'S DECISION

The Court: I will never be able to approve of the position of the OPA in this case in the absence of some mandatory direction from a higher authority.

These defendants did nothing except what they were required by positive direction to do. Suppose they had refused to do it? What position would they have been in? There is no course they could have taken except to do the wrong here complained of. The only reason they did the wrong here complained of was the positive requirement of the OPA.

Surely the Government cannot take on the power positively and without any misapprehension of fact requiring its citizens to do certain acts and then laugh at them afterwards and make fun of them afterwards for having done something which was wrong just because the Government required them to do it.

The Government required them to do a specific thing. The Government through its high and mighty OPA has in effect said that we direct that you do a specific thing, but we dare you even then to do it

except at your own peril. Why, there is no law in that. That is no law. Looked at in the wildest sort of form, the essence of the OPA's position is that you, the defendants, in good faith did what the OPA required you to do, but that requirement was the OPA's error; therefore, you, the innocent defendants, must now pay the OPA for its own error. Never in the world could I consent to lend the authority of this court to perpetuate such injustice as that except in the absence of a positive mandate from a higher authority binding upon this court.

The Court finds that by reason only of the explicit and positive direction of the OPA the defendants applied the wrong ceilings, not as the result of any misinformation supplied by the defendants to the plaintiff, but as the result of defendants pursuing a course of conduct [52] charging prices required by the plaintiff without regard to any representation of fact on the part of defendants material to such positive requirement, and that in the course of time it developed that the OPA in requiring such positive conduct on the part of the defendants was itself in error; and the Court finds in view of all the circumstances here, that there was, in fact, no violation by defendants, because they did in good faith what the OPA required of them. Defendants did nothing except as required by the wholly erroneous, unjustified and positive direction of the OPA itself.

The Court finds no violation by the defendants in this case and decides that the plaintiff take

nothing by its complaint herein and that the same be dismissed.

Will you remind me as to whether or not the statute, the OPA statute, authorizes the Court to award costs against the OPA Administrator?

Mr. Stafford: I will check that, your Honor. I am not prepared to answer at this time.

The Court: I think at present——

Mr. Post: If your Honor please——

The Court: Just a moment.

I think at present the OPA attorneys are pursuing the action in a good faith effort to carry out their own obligations and that they themselves are not in any [53] way personally connected with this misconduct of the business of the OPA.

Now, Mr. Post, I will hear you respecting costs.

Mr. Post: I believe, if your Honor please—the matter of costs that might be assessed against the OPA—it is merely a matter of bookkeeping.

Frequently judgments are taken merely for the amount due and the costs are paid by the OPA. By converse, if the judgment were rendered against the OPA, I believe they would pay the costs. That is my understanding of the regulation at the present time.

The Court: As to costs, I am going to leave the parties where they found themselves.

Mr. Stafford: Does your Honor still advise me to advise the Court——

The Court: No. I am not going to award any costs in this case. Each party will stand its own costs.

Mr. Stafford: Is that all, your Honor.

The Court: Yes, that is all.

I would like to set a time as to when to settle the Order. What time would be convenient?

Mr. Stafford: Today is the 14th. Would it be agreeable, your Honor, if I would present the Order Friday, at 10:00 o'clock? [54]

The Court: Is that agreeable, Mr. Post?

Mr. Post: Yes.

The Court: It is so ordered.

The court will now be adjourned until tomorrow at 10:00 o'clock in the forenoon.

(Whereupon, at 3:00 p.m., an adjournment was taken.)

(Concluded)

CERTIFICATE

I, Bernard Ayres, do hereby certify that as Official Reporter pro tem in the above entitled court I reported the foregoing proceedings and that this transcript is a full and complete record of the same.

/s/ BERNARD AYERS,

Reporter.

[Endorsed]: Filed Sept. 3, 1946. [55]

United States Circuit Court of Appeals
In and for the Ninth Circuit

No. 11420

PAUL PORTER, Administrator, Office of Price
Administration,

Appellant,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
dba DOROTHY HANSCOM'S, a Co-partner-
ship,

Appellee.

STATEMENT OF POINTS AND
DESIGNATION OF RECORD ON APPEAL

Appellant hereby adopts as the Points upon which he will rely in this Appeal the Statement of Points appearing in the Transcript of Record certified by the Court below.

The Clerk will please print the Record in this cause as designated in and certified by the Court below together with this Statement of Points and Designation of Record on Appeal.

/s/ AUSTIN CLAPP,

/s/ WILLIAM B. WEATHERALL,

/s/ DANIEL M. REAUGH,

/s/ FREDERICK W. POST,

Attorneys for Appellant.

[Endorsed]: No. 11420. United States Circuit Court of Appeals for the Ninth Circuit. Paul A. Porter, Administrator, Office of Price Administration, Appellant, vs. Dorothy Hanscom and R. C. Hanscom, doing business as Dorothy Hanscom's, a co-partnership, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division.

Filed September 3, 1946.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 11,420

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

PAUL A. PORTER, Administrator, Office of
Price Administration,

Appellant,

VS.

DOROTHY HANSCOM and R. C. HANSCOM,
d/b/a Dorothy Hanscom's, a Co-part-
nership,

Appellees.

BRIEF FOR APPELLANT.

GEORGE MONCHARSH,

Deputy Administrator for Enforcement,

DAVID LONDON,

Director, Litigation Division,

ALBERT M. DREYER,

Chief, Appellate Branch,

ABRAHAM H. MALLER,

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San Francisco, California.

FILED
NOV 18 1946

PAUL P. O'BRIEN, 
CLERK

Subject Index

	Page
Jurisdiction	1
Statutes and Regulations Involved.....	2
Statement of Facts.....	2
Argument	7
I. The lower court erred in holding that the Adminis- trator was estopped from maintaining the action....	7
II. Good faith is not a defense to the action.....	12
Conclusion	14
Appendix :	
Emergency Price Control Act:	
Section 4 (a)	i
Section 201 (d)	i
Section 205 (e)	i
Revised Procedural Regulation No. 1:	
Section 54	iii
Section 55	iv
Revised Maximum Price Regulation No. 330:	
Section 2	v
Section 3	vi

Table of Authorities Cited

Cases	Pages
Bowles v. Franceschini (C.C.A. 1), 145 F. 2d 510, 514.	14
Bowles v. Hasting (C.C.A. 5), 146 F. 2d 94-95.	14
Bowles v. Indianapolis Glove Company (C.C.A. 7), 150 F. 2d 597, 600	11, 14
Crary v. Porter, decided October 4, 1946; not yet reported	12
Fontes v. Porter, 156 F. 2d 956.	13, 14
Schreffler v. Bowles (C.C.A. 10, 1946), 153 F. 2d 1, 3-4.	10
Wells Lamont Corporation v. Bowles (E.C.A. 1945), 149 F. 2d 364	10

Statutes

Emergency Price Control Act of 1942 (56 Stat. 23, 50 U.S.C. App. 901 et seq.) :	
Section 205 (c)	1
Section 205 (e)	1
Judicial Code (28 U.S.C. § 225), Section 128.	2

Miscellaneous

Revised Maximum Price Regulation No. 330.	2, 4
Section 2 (c)	3, 4, 8
Section 3	3
Revised Procedural Regulation No. 1.	6, 10
Section 54	9
Section 55	9
Section 55 (b)	9

No. 11,420

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

PAUL A. PORTER, Administrator, Office of
Price Administration,

Appellant,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d/b/a Dorothy Hanscom's, a Co-part-
nership,

Appellees.

BRIEF FOR APPELLANT.

JURISDICTION.

This is an appeal by the Price Administrator from a judgment of the District Court for the Western District of Washington, Northern Division, dismissing with prejudice the Administrator's complaint for statutory damages brought pursuant to the provisions of Section 205(e) of the Act. (50 U.S.C. § 925(e).) Jurisdiction of the District Court was invoked under Section 205(c) of the Emergency Price Control Act of 1942, as amended. (50 U.S.C. § 925(c).) The judgment was entered on May 17, 1946 (R. 21-22), and

the Notice of Appeal was filed on August 7, 1946. (R. 22-23.) Jurisdiction of this Court is invoked under Section 128 of the Judicial Code. (28 U.S.C. § 225.)

STATUTES AND REGULATIONS INVOLVED.

The pertinent portions of the Act and the regulations are printed in the Appendix.

STATEMENT OF FACTS.

Appellees, Dorothy Hanscom and R. C. Hanscom are retailers of misses' and women's clothing and do business in Seattle under the name of Dorothy Hanscom's. (R. 5.) They commenced doing business in December, 1943. At that time, appellees' operations admittedly were governed by Maximum Price Regulation No. 330. Pursuant thereto appellees were required to and did adopt the pricing charts of its closest competitor, Best's Inc. of Seattle, as a basis for computing their maximum prices. (R. 5.)

Thereafter, Maximum Price Regulation No. 330 was revised and reissued as Revised Maximum Price Regulation No. 330, and became effective on September 18, 1944.

The revised regulation changed the method of determining the price ceilings for retailers as follows:

Dealers were required to compute the ceiling prices by calculating the markup which they took on gar-

ments delivered during the "base period", and applying that markup to their cost of the garments. (Sec. 2(a).)

Two different "base periods" were established for retailers. The base period of August 1 to December 31, 1942 was prescribed for those retailers who made deliveries during that period. For retailers who made their first delivery of garments after October 1, 1941, but before May 18, 1944, the "base period" was the first four months immediately following the first delivery of garments. (Sec. 2(c).)

All dealers were required to file with the district office of the Office of Price Administration, price charts showing selling prices at which they delivered garments during the "base period". (Sec. 3.)

The regulation also contained a note in Section 3 to the effect that the expression "pricing chart" meant a correct pricing chart and that if the seller filed an incorrect or improper pricing chart, his maximum prices should be calculated on the basis of a correct pricing chart.

Under date of September 14, 1944, the Seattle District Office sent a mimeographed letter addressed "To all dealers in Women's, Misses' and Children's Outerwear Garments" over the mimeographed signature of Reed C. Mills, District Price Executive, by Ruth Sollie, Apparel Section. This letter, a copy of which was sent to appellees, advised the dealers of the issuance of the revised regulation and that it was necessary for them to file two signed copies of the pricing

chart, which they had previously prepared in conformance with Maximum Price Regulation No. 330. (R. 6-7.)

On October 7, 1944, a mimeographed Second Notice, identical with the one above discussed was sent to all dealers, including appellees. (R. 7.)

These notices were correct only as the revised regulation applied to retailers who had been in business and had made deliveries during the period between August 1st and December 31, 1942. As to appellees or any retailer who had not made deliveries during that period, these notices were clearly inapplicable, since the Revised Regulation under Section 2(c) prescribed an entirely different base period.

Subsequently, on or about October 12, 1944, appellees filed with the Seattle District Office the pricing charts of Best's Inc. which they had previously adopted as their own under the earlier regulation. (R. 8.) The receipt of the pricing charts was acknowledged by the District Office in a letter which contained the following *caveat*:

“This acknowledgment is not to be considered as an approval of the factual or mathematical accuracy of the information on the pricing chart. Even though you have filed these figures, if they are incorrect, you are not permitted to take a higher percentage markup than that authorized by Revised Maximum Price Regulation No. 330. However, if you find that your pricing chart is incorrect, you may file an amended pricing chart setting forth the inaccuracies.” (R. 9.)

Thereafter, on November 26, 1945, the Seattle District Office advised appellees that the charts which they had filed were erroneously compiled and did not meet the requirements of Revised Maximum Price Regulation No. 330; that appellees should have filed a base period pricing chart based upon deliveries of garments during the first four months following the first delivery of garments by appellees; and requested appellees to file an amended pricing chart, which appellees did. (R. 9-10.)

The amended pricing charts filed by appellees resulted in lower maximum prices for appellees. During the period from January 22, 1945 to the date of the filing of this action, the appellees admittedly had sold apparel at prices in excess of the maximum permitted under the revised regulation, as fixed by the amended pricing charts, totalling \$714.01. (R. 11.)

The Administrator commenced this action for statutory damages by reason of such overcharges. (R. 2.) The appellees filed an answer admitting the facts above set forth, but alleging that the violations complained of were committed in good faith and that the Administrator was estopped from prosecuting the action. (R. 4.)

Prior to the trial, the Administrator entered into a stipulation with the appellees in which he conceded that appellees' violations had not been committed wilfully, and, therefore, in the event that judgment would be rendered in favor of plaintiff, he would ask for

damages not to exceed \$714.01, the amount of the overcharges. (R. 15-16.)

The appellant made a motion for judgment on the pleadings, which motion was denied. (R. 16-18.)

As has been indicated, the facts were not in dispute and were stipulated. (R. 19.) The issue at the trial was whether appellees had a right to rely upon the mimeographed notices instead of following the requirements of the regulation, and, conversely, whether the Administrator was estopped by reason of the notices from bringing this action. We shall not discuss the evidence offered at the trial, since, as we shall show in our argument, the issue is determined by the provisions of Revised Procedural Regulation No. 1, which the Administrator had promulgated to cover a situation such as is presented in the case at bar.

The trial Court found that the actions of appellees were solely and directly caused by orders given to appellees by plaintiff, and that plaintiff was estopped from maintaining the action; that the plaintiff had failed to prove a violation of any statute or regulation; and entered judgment dismissing the complaint with prejudice. (R. 21-22.) The trial Court's oral decision appears at R. 67.

From that judgment this appeal is being prosecuted.

ARGUMENT.**I.**

THE LOWER COURT ERRED IN HOLDING THAT THE ADMINISTRATOR WAS ESTOPPED FROM MAINTAINING THE ACTION.

Preliminarily, we note that the Court in its judgment (R. 21-22) made a finding that plaintiff had failed to prove any violations of any statute or regulation. Actually, this finding is the conclusion at which the lower Court arrived as a result of its holding that the Administrator was estopped from maintaining the action. This is evidenced by the Court's discussion in its oral decision at R. 67-68. The fact that appellees violated the Revised Regulation by selling in excess of the maximum prices permitted to them, as determined by their amended pricing chart, is not disputed by them. (Paragraph IX, defendant's answer, R. 11.)¹ The amount of the overcharges is admitted by appellees to total \$714.01.

The defense raised by appellees was that although they did sell in excess of the maximum prices, they acted pursuant to orders from the Seattle District Office, without any intent to violate; and that plaintiff therefore was estopped from prosecuting the action. (R. 11-12.)

Appellant does not dispute the fact that appellees in filing their first pricing chart under the Revised

¹The first pricing chart filed by appellees was admittedly incorrect in that it did not conform to the requirements of the Revised Regulation and did not have the effect of establishing for appellees a higher maximum price than that to which they were entitled under the Revised Regulation. See note following Section 3(a)(8) of Revised Maximum Price Regulation No. 330, set forth in the Appendix.

Regulation followed the directions contained in the general mimeographed notices sent to them. However, the issue on this appeal is whether appellees had the legal right to rely upon these general mimeographed notices instead of following the requirements of the Revised Regulation. As pointed out in the Statement of Facts, these notices were correct only as the revised regulation applied to retailers who had been in business and had made deliveries during the period between August 1st and December 31, 1942. As to appellees or any retailer who had not made deliveries during that period, these notices were clearly inapplicable, since the Revised Regulation under Section 2(c) prescribed an entirely different base period. Appellees did not dispute the fact that under the provisions of the Revised Regulation, the pricing chart followed by them was incorrect, since it was not based upon deliveries made by appellees during the first four months immediately following the first deliveries of garments.

The fact that appellees followed the directions contained in the general mimeographed notices, instead of looking to the regulation itself, did not have the effect of absolving them from liability. At most, it is evidence of the fact that they did not violate wilfully. In the operation of an agency of the size of the Office of Price Administration, it is inconceivable that every employee should have the power to interpret the regulations and to bind the Administrator by such interpretations. Such a situation would result in an utter confusion of conflicting and erroneous interpre-

tations which, if binding upon the Administrator, would make enforcement difficult, if not impossible. On the other hand, it is proper that the Administrator should be bound by interpretations issued by those persons whom the Administrator has authorized to issue interpretations. So that the public may know who are the persons upon whose interpretations it may rely, and the circumstances under which official interpretations are issued, the Administrator had promulgated Sections 54 and 55 of Revised Procedural Regulation No. 1, which are set forth in full in the Appendix. The purpose of these Sections was to avoid just such controversies and claims as were asserted by the appellees in the lower Court.

A district price executive is not one of the persons listed in Section 55(b) as one authorized to issue official interpretations. Consequently, the general mimeographed notices which he issued "To all Dealers in Women's, Misses', and Children's Outer Wear Garments", and sent to appellees, did not constitute such an interpretation as could protect appellees and bind the Administrator. Appellees were required to look to the regulation itself. Had they done so, they would have found what their base period was and would have prepared and filed a correct pricing chart, as they eventually did. If they had any doubt as to the requirements of the regulation, they should have applied for an official interpretation in accordance with Sections 54 and 55 of Revised Procedural Regulation No. 1. Admittedly, appellees did not do so. (R. 62.)

It is well settled that appellees had no right to rely upon the mimeographed notices. In *Wells Lamont Corporation v. Bowles* (E.C.A. 1945), 149 F. (2d) 364, the Court said on page 367:

“It must be presumed that complainant was advised of the procedure it was required to follow in order to obtain an official interpretation upon which it could properly rely. And, since it failed to comply with the prescribed method, it is not entitled to rely upon unofficial oral advice given by subordinate officials in the Office of Price Administration. At first blush, this may seem harsh but, obviously, the Administrator can not be bound by various oral interpretations which happen to be made by his hundreds, perhaps thousands, of employees, in violation of published regulations. He has prescribed a reasonable procedure by which persons subject to the regulations may obtain official interpretations, by which all will be bound. Complainant is not entitled to rely on an unofficial interpretation. *Nichols & Co. v. Secretary of Agriculture*, 1 Cir., 131 F. 2d 651; *United States v. San Francisco*, 310 U. S. 16, 60 S. Ct. 749, 84 L. Ed. 1050; *Utah Power & Light Co. v. United States*, 243 U. S. 389, 37 S. Ct. 387, 61 L. Ed. 791; *Fleming v. Miller*, D. C. 47 F. Suppl. 1004”.

To the same effect is *Schreffler v. Bowles* (C.C.A. 10, 1946), 153 F. (2d) 1, 3-4.

Although the Courts in the preceding cases refer to oral interpretations, the same rule applies to written interpretations which are not official interpretations as described in Revised Procedural Regulation No. 1.

In *Bowles v. Indianapolis Glove Company* (C.C.A. 7, 1945), 150 F. (2d) 597, the Court said at page 601:

“Defendant’s last contention is of estoppel. It bases this argument on the conduct of the Administrator in inducing it, for a part of the period complained of, to sell its gloves at prices now charged to violate the law. A similar argument was presented to the Emergency Court of Appeals in the case, *Wells Lamont Corporation v. Bowles*, 149 F. 2d 364, 367. The court, speaking through Judge Lindley, said, ‘It must be presumed that complainant was advised of the procedure it was required to follow in order to obtain an official interpretation upon which it could properly rely. And, since it failed to comply with the prescribed method, it is not entitled to rely upon unofficial oral advice given by subordinate officials in the Office of Price Administration. At first blush, this may seem harsh but, obviously, the Administrator can not be bound by various oral interpretations which happen to be made by his hundreds, perhaps thousands, of employees, in violation of published regulations. He has prescribed a reasonable procedure by which persons subject to the regulations may obtain official interpretations, by which all will be bound. Complainant is not entitled to rely on an unofficial interpretation.’ *That part of the advice relied upon by defendant in the case at bar to sustain its charges of estoppel was in writing makes it no more binding upon the Administrator than the oral advice in the Wells case.*” (Italics supplied.)

Since the mimeographed notices upon which appellees relied are not official interpretations, the lower

Court clearly erred in holding that the Administrator was estopped from maintaining the suit by virtue of those notices.

II.

GOOD FAITH IS NOT A DEFENSE TO THE ACTION.

In its judgment (R. 21) the Court did not predicate its action in dismissing the complaint upon the fact that the defendant had acted in good faith. However, the Court discusses the defendant's good faith, as well as the alleged estoppel, in its oral decision (R. 67-68) as a basis for its judgment. We shall, therefore, briefly discuss the effect of the fact that the defendants violated the regulation in good faith.

It is well settled that good faith is not a defense to an action for statutory damages for violation of a regulation. The recent decision of the Circuit Court of Appeals for the Eighth Circuit, in the case of *Crary v. Porter*, decided October 4, 1946, not yet reported, presents a thorough discussion of this contention. The Court there said:

“It is argued that section 205 (d) of the Act, 50 U.S.C.A. Appendix §925(d), exempts a seller from liability for violating a price regulation, if he has acted in good faith. Appellants have misread the language and purpose of this section of the statute. The section provides that ‘No person shall be held liable for damages or penalties * * * on any grounds for or in respect of anything done or omitted to be done in good faith pursuant to any provision of this Act or any regulation, order, price schedule, requirement, or agreement there-

under * * * notwithstanding that subsequently such provision, regulation, order, price schedule, requirement, or agreement may be modified, rescinded, or determined to be invalid. * * *

Clearly, this provision has application only to things done pursuant to or in conformity with the Emergency Price Control Act and not to things done contrary to or in violation of it, whether in good or bad faith. As the report of the Senate Committee on Currency and Banking declared, Sen. Rep. 931, 77th Cong., 2d Sess., at the time the statute was enacted, 'of course Section 205(d) does not confer any immunity upon any person who violates any such provision, regulation, order or requirement.' See also *Bowles v. Indianapolis Glove Co.*, 7 Cir., 150 F. 2d 597, 600; *Bowles v. Franceschini*, 1 Cir., 145 F. 2d 510, 512-514; *Schreffler v. Bowles*, 10 Cir., 153 F. 2d 1, 4. For any violation of a price regulation, the liability in damages is governed by section 205(e) as amended, 50 U.S.C.A. Appendix §925(e), and under that section good faith is in no way a defense to the recovery of overcharges but is relevant only on whether and how much the recovery should be increased beyond that amount in achieving the purposes of the Act. Cf. *Speten v. Bowles*, 8 Cir., 146 F. 2d 602; *Shearer v. Porter*, 8 Cir., 155 F. 2d 77; *Bowles v. Franceschini*, 1 Cir., 145 F. 2d 510, 513, 514."

This Court, as well as other Circuit Courts of Appeals, have also had occasion to discuss the effect of good faith by a person who violates. In *Fontes v. Porter*, 156 F. (2d) 956, this Court said at page 958:

"Appellant says that his good faith in the transaction should be taken into account. Good

faith, however, is not a defense to an action for damages. Lack of willfullness, coupled with the taking of practicable precautions against the occurrence of a violation, operates only to reduce damages to the amount of the overcharge. Consult § 205(e).”

To the same effect are:

Bowles v. Hasting (C.C.A. 5), 146 F. (2d) 94, 95;

Bowles v. Indianapolis Glove Company (C.C.A. 7), 150 F. (2d) 597, 600;

Bowles v. Franceschini (C.C.A. 1), 145 F. (2d) 510, 514.

As this Court pointed out in the *Fontes* case, the effect of good faith, i.e., lack of willfullness, when coupled with the taking of practicable precautions against the occurrence of the violation, operates only to reduce the damages to the amount of the overcharge. Since the Administrator had stipulated that in the event judgment was rendered in favor of the plaintiff, he would not ask for damages to exceed the amount of the overcharge, appellees were in a position to obtain every advantage to which their good faith entitled them.

CONCLUSION.

Appellees admittedly violated the revised regulation by selling in excess of the maximum prices permitted by the revised regulation. The circumstances relied upon by appellees to absolve them from liability are not valid defenses to the action. Their lack of will-

fullness in violating goes merely to the amount of damages which may be recovered against them. The fact that appellees relied upon the mimeographed notices instead of looking to the revised regulation does not create an estoppel against the Administrator, since the mimeographed notices did not constitute an official interpretation.

The judgment below is therefore clearly erroneous and should be reversed and the case remanded, with directions to the lower Court to enter judgment in favor of the plaintiff in the sum of \$714.01 and costs.

Dated, November 15, 1946.

Respectfully submitted,

GEORGE MONCHARSH,

Deputy Administrator for Enforcement,

DAVID LONDON,

Director, Litigation Division,

ALBERT M. DREYER,

Chief, Appellate Branch,

ABRAHAM H. MALLER,

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WILLIAM B. WETHERALL,

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Office of Price Administration,

San Francisco, California.

(Appendix Follows.)

Appendix.

Appendix

STATUTES AND REGULATIONS INVOLVED.

STATUTE.

The pertinent provisions of the Emergency Price Control Act (50 U.S.C. §901, et seq.) are as follows:

SEC. 4. (a) It shall be unlawful, regardless of any contract, agreement, lease, or other obligation heretofore or hereafter entered into, for any person to sell or deliver any commodity, or in the course of trade or business to buy or receive any commodity, or to demand or receive any rent for any defense-area housing accommodations, or otherwise to do or omit to do any act, in violation of any regulation or order under section 2, or of any price schedule effective in accordance with the provisions of section 206, or of any regulation, order, or requirement under section 202 (b) or section 205 (f), or to offer, solicit, attempt, or agree to do any of the foregoing.

Section 201(d):

The Administrator may, from time to time, issue such regulations and orders as he may deem necessary or proper in order to carry out the purposes and provisions of this Act.

Section 205(e):

If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may, within one year from the date of the occurrence

of the violation, except as hereinafter provided, bring an action against the seller on account of the overcharge. In such action, the seller shall be liable for reasonable attorney's fees and costs as determined by the court, plus whichever of the following sums is the greater: (1) Such amount not more than three times the amount of the overcharge, or the overcharges, upon which the action is based as the court in its discretion may determine, or (2) an amount not less than \$25 nor more than \$50, as the court in its discretion may determine: Provided, however, That such amount shall be the amount of the overcharge or overcharges or \$25, whichever is greater, if the defendant proves that the violation of the regulation, order, or price schedule in question was neither wilfull nor the result of failure to take practicable precautions against the occurrence of the violation. For the purposes of this section the payment or receipt of rent for defense-area housing accommodations shall be deemed the buying or selling of a commodity, as the case may be; and the word "overcharge" shall mean the amount by which the consideration exceeds the applicable maximum price. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer either fails to institute an action under this subsection within thirty days from the date of the occurrence of the violation or is not entitled for any reason to bring the action, the Administrator may institute such action on behalf of the United States within such one-year period. * * *

REGULATIONS.

The pertinent provisions of Revised Procedural Regulation No. 1 (7 F.R. 8961) are as follows:

Pursuant to the authority of sections 201 (d) and 203 of the Emergency Price Control Act of 1942, as amended (Pub. Laws 421 and 729, 77th Cong., E.O. 9250, 7 F.R. 7871) Procedural Regulation No. 1—Procedure for the Issuance, Protest and Amendment of Maximum Price Regulations, is hereby revoked and the following rules are prescribed for the issuance, adjustment, amendment, protest and interpretation of maximum price regulations:

* * * * *

ARTICLE VI—INTERPRETATIONS.

SEC. 54. *Interpretations.* An interpretation rendered by an officer or employee of the Office of Price Administration with respect to any provision of the Act or of any regulation, price schedule, order, requirement, or agreement thereunder, will be regarded by the Office of Price Administration as official only if such interpretation was requested and issued in accordance with section 55 of this regulation. Action taken in reliance upon and in conformity with an official interpretation and prior to any revocation or modification thereof or to any superseding thereof by regulation, order or amendment, shall constitute action in good faith pursuant to the provision of the Act, or of the regulation, price schedule, order, requirement or agreement to which such official interpretation relates. An official interpretation shall be applicable only with respect to the particular person to whom, and to the particular

factual situation with respect to which, it is rendered, unless publicly announced as an interpretation of general application.

SEC. 55. *Requirements governing interpretations—*(a) *Requests for interpretations; form and contents.* Any person desiring an official interpretation of the Emergency Price Control Act of 1942 or any regulation, price schedule, order, requirement or agreement thereunder shall request it in writing from the nearest district office of the Office of Price Administration. Such request shall set forth in full the factual situation out of which the interpretative question arises and shall, so far as is practicable, state the names and post office addresses of the persons involved. If the inquirer has previously requested an interpretation on the same or substantially the same facts, his request shall so indicate and shall name the official or office to whom his previous request was addressed. If the interpretation will affect operations of establishments located in more than one state, the request shall name the states in which the establishments are located. No interpretation shall be requested or given with respect to any hypothetical situation or in response to any hypothetical question.

(b) *Interpretation to be written; authorized officials.* Official interpretations shall be given only in writing, signed by one of the following officers of the Office of Price Administration: The Price Administrator, the General Counsel, any Associate or Assistant General Counsel, any Regional Attorney, any Regional Price Attorney, any District Price Attorney, and any Division

Counsel to a Price Division or Chief Counsel to a Price Branch in the Office of Price Administration, Washington, D. C., *Provided*, That interpretations of general application shall be announced only by the Price Administrator, the General Counsel, any Associate or Assistant General Counsel, or any Regional Attorney or any Regional Price Attorney.

* * * * *

The pertinent provisions of Revised Maximum Price Regulation No. 330 (9 F.R. 11350) are as follows:

SEC. 2. *How to find your ceiling prices under this regulation—*(a) *Explanation of rules.* You find your ceiling price under this regulation by calculating the markup which you took on garments you delivered during the “base period”, and then applying that markup to the cost of the garments you are pricing. You find what the “base period” markup is by using one of the pricing rules which are given in section 4.

* * * * *

(c) *What is the “base period?”* The base period is very important because you must figure your mark-up from your deliveries of garments during that period.

(1) *For sales of toddlers’ garments, or blouses under size 30, or slacks and slack suits.* (i) The “base period” for all garments in categories 5a, 10a, 15a, 20a, 25a, 26a, 26b, and 32-39 is the period between August 1 and December 31, 1942 for retailers and the period between July 1 and October 31, 1942 for wholesalers.

(ii) For retailers who made their first delivery of garments in categories 5a, 10a, 15a, 20a, 25a, 26a, 26b, or 32-39 after October 1, 1942 (September 1, 1942 for wholesalers) but before May 18, 1944 the "base period" is the first four months immediately following the first delivery of garments.

(2) *For sales of garments in all other categories.* (i) The "base period" for retailers is the period between August 1 and December 31, 1941; for wholesalers, it is the period between July 1 and October 31, 1941.

(ii) For retailers who made their first delivery of garments in these categories after October 1, 1941 but before May 18, 1944, and for wholesalers who made their first delivery of garments after September 1, 1941, but before May 18, 1944 the "base period" is the first four months immediately following the first delivery of garments.

SEC. 3. *Pricing charts.* In order to price under this regulation you must have a pricing chart. If you price under section 5 your order of authorization will set forth your pricing chart, and you do not need to file a chart. On or before October 15, 1944, every seller subject to this regulation (except sellers who apply under section 5 and sellers who are members of chains which have received orders authorizing uniform pricing from the OPA), must file two signed copies of a pricing chart with the Office of Price Administration at the district office having jurisdiction over the area in which the seller is located. You must keep a copy of the pricing chart for your own use. On and after November 15, 1944, you may not sell or deliver any garments subject to this

regulation unless you have received an acknowledgment from the OPA of the filing of your pricing chart as required by this section.

(a) *How to prepare a pricing chart.* Each pricing chart must contain the following:

(1) The seller's name and address.

(2) Type of seller (wholesaler—with stock, without stock, etc.; retailer—basement department, chain outlet, specialty shop, etc.).

(3) If your first delivery of any category covered by this regulation was after October 1, 1941 (September 1, 1941 for wholesalers), then list the date of such first delivery.

(4) A list of the categories you delivered during your base period.

(5) A list of the cost prices at which you purchased garments in each of these categories. You must indicate whether this is a unit or dozen price. If you intend to use the exception provided in Rule 1 (section 4 (b) (1) for any cost prices, such cost prices on your pricing chart should be preceded by the symbol "S".

(6) The discount, terms or allowance at which you purchased the largest number of garments at each cost price listed in (5). (Wholesalers must also include the discounts, terms and allowances on which they customarily sold.)

(7) The selling price at which you delivered, during the base period, the largest number of garments of each cost price listed in (5).¹ If during

¹The selling price authorized for a particular cost price in any category by an order granting an adjustment under MPR 153, as amended, shall be deemed to be the selling price at which the seller during the base period delivered the largest number of garments of that category having the same cost price.

the base period you delivered an equal number of garments at two or more different selling prices, list the lowest of these selling prices. (Wholesalers must indicate whether this is a unit or dozen price.)

For example: During the base period you delivered a total of 250 women's dresses (Category 21) which you bought at a \$6.75 cost price. Of these 250 dresses, your selling price was \$9.95 for 50 of the dresses, \$10.95 for 125 of them, and \$11.95 for 75 of them. You list \$10.95 on your pricing chart as the price at which you delivered during the base period the largest number of women's dresses costing \$6.75. If you had delivered 125 of these dresses at \$9.95 and 125 at \$10.95, you would list \$9.95 as the selling price at which you delivered the largest number of women's \$6.75 dresses.

(8) The percentage markup taken on each selling price listed in 7.²

An example of a pricing chart and detailed instructions for its preparation are found in Appendix B.

Selling price lines and percentage markups of sellers who made their first deliveries after June 15, 1942 may be revised at any time by the OPA if they were improperly established or are based on an improper selection of competitors.

NOTE: Throughout this regulation, reference is made to categories, prices and markups listed

²Any percentage markup authorized for a particular cost price and/or category by an order granting an adjustment under MPR 153, as amended, shall be deemed to be the percentage markup taken by the seller on the largest number of garments of that cost price and/or category delivered during the base period.

on the seller's pricing chart. The expression "pricing chart" is intended to refer to a pricing chart correctly prepared in accordance with the instructions contained in paragraph (a) of this section. If a seller's pricing chart is improper or inaccurate, his maximum prices under section 4 of this regulation shall be prices calculated on the basis of a correct pricing chart.

(b) *How to amend a pricing chart.* If you have filed your pricing chart, and then find that it was incorrect, you may file with the district office where you filed your original chart two signed copies of an amended pricing chart setting forth the inaccuracies and the reasons therefor. However, until you have received an acknowledgment from the OPA of the receipt of this amended pricing chart, you must not take a higher percentage markup than that previously reported, or permitted under this regulation, whichever is lower.

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

PAUL A. PORTER, Administrator, Office
of Price Administration, *Appellant*,
vs.

DOROTHY HANSCOM and R. C. HANS-
COM, d/b/a Dorothy Hanscom's, a Co-
partnership, *Appellees*.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEES

MERRITT, SUMMERS & BUCEY

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FILED

DEC 13 1946

IN THE
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INDEX

	<i>Page</i>
Statement of Facts.....	1
Argument	4
Contention of the Defendants.....	4
Appellant's Authorities Not in Point.....	6
Principle of Estoppel Applies to this Case.....	10
Neither Appellant nor the Public Has Suffered Damage	10
Conclusion	11

TABLE OF CASES

<i>Bowles v. Griffin</i> (5 C.C.A.) 151 F.(2d) 458.....	7, 8, 10, 12
<i>Bowles v. Hastings</i> (5 C.C.A.) 146 F.(2d) 94.....	6
<i>Bowles v. Indianapolis Glove Co.</i> (7 C.C.A.) 150 F.(2d) 597	6, 7
<i>Crary v. Porter</i> —Decided Oct. 4, 1946, not yet re- ported	6
<i>Fitch v. U.S.</i> (9 C.C.A.) 234 Fed. 608; 236 Fed. 133	10
<i>Fontes v. Porter</i> (9 C.C.A.) 156 F.(2d) 956.....	6
<i>Schreffler v. Bowles</i> (10 C.C.A.) 153 F.(2d) 1..	6, 7
<i>Wells, Lamont Corp. v. Bowles</i> (U.S. Emergency Ct. of Appeals) 149 F.(2d) 364.....	6
<i>U.S. v. Denver & R.G.W.R.Co.</i> (8 C.C.A.) 16 F. (2d) 374	10

STATUTES

Title 50, App. 924, §§(b) & (d), U.S.C.A.....	12
-----------------------------------------------	----

REGULATIONS

Maximum Price Regulation No. 330.....	1
Revised Maximum Price Regulation No. 330.....	2, 4, 10, 11
Revised Procedural Regulation No. 1.....	5

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

PAUL A. PORTER, Administrator, Office
of Price Administration, *Appellant,*

vs.

DOROTHY HANSCOM and R. C. HANS-
COM, d/b/a Dorothy Hanscom's, a Co-
partnership, *Appellees.*

No. 11420

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEES

STATEMENT OF FACTS

Prior to September 14, 1944, the defendants in this case were operating a retail business in which they offered for sale misses' and women's clothing. At that time the defendants' business was governed by Maximum Price Regulation No. 330 issued by the Office of Price Administration. The defendants had previously filed pricing charts based on those of their closest competitors, about which pricing charts there is no question (R. 5).

Shortly after September 14, 1944, and in due course of mail, the defendants received a communication from the District Price Executive, Mr. R. C. Mills, informing them as follows:

“Revised Maximum Price Regulation No. 330 which governs the maximum prices to be charged for women’s, children’s and misses’ outer wear garments has just been issued and is effective September 18, 1944.

“According to this revised regulation it is necessary that you file two signed copies of the pricing chart which you have previously prepared in conformance with Maximum Price Regulation No. 330 * * * by October 15, 1944 * * *. On and after November 15, 1944, you may not sell any garments subject to this regulation unless you have received an acknowledgment from the OPA of the filing of your pricing chart * * *.” (R. 6)

On October 7, 1944, the defendants received a second communication from the District Price Executive, Mr. R. C. Mills, which reads exactly the same as that communication of September 14, 1944 (R. 7).

The defendants filed copies of their pricing chart as required by the above two communications on October 12. On October 14 the defendants received an acknowledgement of these filings (R. 8).

At no time prior to October 15 was a copy of Revised Maximum Price Regulation No. 330 available to the defendants (R. 9).

The defendants heard nothing from the Office of

Price Administration with reference to the above matter until a little more than a year later when under date of November 26, 1945, the Seattle District Director advised the defendants that their pricing chart had been erroneously compiled and that they should have used the first four months of the operation of their business as a base instead of using the base as directed by the letters above referred to. Upon receipt of this last mentioned communication the defendants promptly complied and changed their base to conform with these last directions (R. 10).

The Administrator then filed his complaint for triple damages without alleging an amount (R. 2).

After the defendants had answered the parties entered into two stipulations (R. 15 and 19) in which they agreed on the amount of the overcharges, if any, and that the overcharges, if any, were not willfully made or made through failure to exercise due precaution, and that the Administrator would not ask for triple damages. The parties then further stipulated that all facts in the answer are true except that Reed C. Mills and Ruth Sollie were duly authorized and empowered representatives of the plaintiff and were acting within the scope of their authority in sending the above referred to communications; and then defined the issues in the case as whether or not Mr. Mills, the District Price Executive, and Ruth Sollie of the Apparel Section acted within the scope of their authority in sending to the defendants the communications of September 14, 1944, and October 7, 1944, and whether the defendants were required to comply literally with the instructions contained in

these communications and whether the defendants were justified in complying with these instructions, and whether the defendants' compliance with these instructions constituted a defense.

The Administrator then moved for a judgment on the pleadings which was denied (R. 18). At the trial the appellant refused to offer evidence (R. 31). The defendants then proceeded with their case, at the close of which the court gave his decision for the defendants (R. 21).

ARGUMENT

IT IS THE CONTENTION OF THE DEFENDANTS THAT THE COMMUNICATIONS OF SEPTEMBER 14, 1944, AND OCTOBER 7, 1944, ABOVE REFERRED TO, WERE ORDERS TO BE COMPLIED WITH; THAT THE OFFICE OF PRICE ADMINISTRATION HAD AMPLE AUTHORITY TO ISSUE THEM; AND THAT THE DEFENDANTS HAD EVERY RIGHT TO ACCEPT AND ACT UPON THEM AS ORDERS WITHOUT QUESTION.

It is impossible to make anything out of the above communications other than that they are routine orders or directions issued from the Office of Price Administration. At the time these directions were issued Revised Maximum Price Regulation No. 330 was not available to the defendants, but the District Price Executive (Mr. R. C. Mills) knew what was in it because both communications state, "according to the revised regulation" and further "in conformance

with Maximum Price Regulation No. 330." These communications further state, "on or after November 15, 1944, you may not sell any garments subject to this regulation unless you have received an acknowledgement from the OPA of the filing of your pricing chart."

Assuming for a minute that the defendants are correct in their contention that these communications were orders, then there is absolutely no question but that Mr. R. C. Mills, the District Price Executive, was acting within the scope of his authority when he sent these communications to the defendants (R. 46 and 47), but in this instance it turns out that these orders were wrong and Mr. Mills had made a mistake, so the Office of Price Administration takes the position that the communications of the District Price Executive were not orders or directions but opinions which, under the authority of Revised Procedural Regulation No. 1, §55(b), he had no right to give.

Appellant on page 8 of his brief states that these communications were clearly inapplicable to the defendants since the revised regulation prescribed an entirely different base, and if they had any doubt they should have applied for an official interpretation (page 9, Appellant's brief). You cannot possibly read this inapplicability into or from these communications. They appear on their face to be exactly in point with the defendants' business, and if the inapplicability is so clear, why did not Mr. Reed C. Mills see it. He had access to the revised regulations while the defendants in this case did not have.

APPELLANT'S AUTHORITIES NOT IN POINT

The appellant, when citing these authorities, assumes that the above referred to communications are opinions wrongfully delivered by an agent acting beyond and outside of the scope of his authority, and further, upon the erroneous belief that the defendants are relying upon the defense of good faith alone.

Under the rulings of the various Circuit Courts of Appeal, as laid down in the cases of

Crary v. Porter, decided Oct. 4, 1946 (not yet reported);

Fontes v. Porter, 156 F.(2d) 956;

Bowles v. Hastings (5 C.C.A.) 146 F.(2d) 94;

and others, good faith, alone, or standing by itself, is not a defense, but merely can be pleaded as mitigation of damage.

Appellant then makes the statement that the appellees have no right to rely on mimeographed notices (Appellant's Br. 10) and cites:

Wells, Lamont Corporation v. Bowles (U. S. Emergency C. of A.) 149 F.(2d) 364;

Schreffler v. Bowles (10 C.C.A.) 153 F.(2d) 1, and

Bowles v. Indianapolis Glove Company (7 C.C.A.) 150 F.(2d) 597;

to sustain his contention.

In the *Wells, Lamont* case, *supra*, Mr. Wells sought

advise from the Chief of the Work Clothing Unit of OPA, who advised him that his published prices were the ceilings. Mr. Wells relied upon this oral advice, and the court held that he should not have done so.

In *Schreffler v. Bowles*, *supra*, there is the same set of facts. "R. E. Schreffler sought and obtained from one F. R. Wildmer, an employee of the OPA, in Washington, D. C., advise as to his rights to charge the prices in question." The court held he should have followed the prescribed method of obtaining an opinion.

In *Bowles v. Indianapolis Glove Company*, *supra*, the defendant relied upon a letter from the OPA to establish his defense of estoppel, which is published in part in the court's opinion. In this letter the writer states that he is in doubt as to the defendant's position, but that in no way does the letter validate the prices charged by the defendant.

In none of the foregoing cases did the defendants receive a direct order to do or refrain from doing something, and in each case the court held that the defendant sought an opinion and that he should have gone through channels to get it.

The defendants herein submit to the Court that the case of *Bowles v. Griffin* (5 C.C.A.) 151 F.(2d) 458, 460, is more nearly in point with the case at hand. In this case the Rent Director made an order based on the landlord's affidavit that the rent charged was \$9.00 per week. Later the Director decided the affidavit was false, and made another order to the effect that \$20.00 per month was the proper charge.

This action was brought for the overcharge made during the periods between the first and second orders, and the court held:

“The penalties, for they are such (*Thierry v. Gilbert*, 1 Cir., 147 F.2d 603; *Lambur v. Yates*, 8 Cir., 148 F.2d 137), sued for here under Sect. 205(e) are recoverable only ‘if any person selling a commodity violates (note the present tense) a regulation, order, or price schedule prescribing a maximum price,’ the receipt of rent for the use of a house being expressly declared to be deemed a selling of a commodity; and Sect. 205(d) declared as a defense that ‘No person shall be held liable for damages or penalties * * * on any grounds for or in respect of anything done * * * in good faith pursuant to any provision of this Act or any regulation, order * * * of the Office of Price Administration * * * notwithstanding that subsequently such provision, regulation, or order * * * may be modified, rescinded, or determined to be invalid.’ In this case as to each transaction of rent collection which is proven the district court has the jurisdiction and the duty to decide whether or not it was done in violation of any regulation or order existing at the time; and if at that time it was done in good faith pursuant to an order then in force, a defense is to be held established although the order has since been rescinded. Its enquiry on these points cannot be cut off and foreclosed by fact finding of the Administrator.” *Bowles v. Griffin*, 151 F.(2d) 458, 460.

It seems clear that the District Price Executive had authority to give an order (R. 46 and 47). Also see *Bowles v. Griffin*, 151 F.(2d) 458, 460, wherein the court states:

“It is suggested in oral argument that these special orders made by a Rent Director are not regulations or orders of the Administrator referred to in Section 204(d). That subsection denies jurisdiction to any court, except the Emergency Court, ‘to consider the validity of any such regulation, order, or price schedule.’ The regulations and orders are those authorized in Section 2, and again more broadly in Sect. 201 (d): ‘The Administrator may, from time to time, issue such regulations and orders as he may deem necessary or proper in order to carry out the purposes and provisions of this Act.’ These Sections speak of the Administrator alone, but manifestly one man, while he could make the general provisions usually referred to as regulations, could not himself make all the determinations of more limited or individual application which are usually spoken of as orders. Accordingly Section 201(a) provides: ‘The Administrator may * * * appoint such employees as he deems necessary in order to carry out *his functions and duties* under this Act * * * and may utilize and establish such regional, local, or other agencies * * * as may from time to time be needed.’ Section 201(b), after locating his principal office in the District of Columbia, declares: ‘but he or any *duly authorized representative* may exercise *any or all of his powers* in any place.’ (Italics added.) The Administrator could appoint a Rent Director for this Defense Area and authorize him to fix by orders maximum rents for the housing accommodations therein.”

PRINCIPLE OF ESTOPPEL APPLIES TO THIS CASE

That the principle of estoppel can apply to the plaintiff is made clear in the case of *U. S. v. Denver & R. G. W. R. Co.* (8 C.C.A.) 16 F.(2d) 374, 376, in which the court said:

“The equitable claims of the State or the United States are no stronger than those of an individual under like circumstances and a State or the United States may waive a claim and be estopped from the assertion of a claim under circumstances that would estop an individual from the assertion of a similar claim.”

Also see *Fritch v. U. S.* (9 C.C.A.) 234 Fed. 608, 236 Fed. 133.

That the principle of estoppel can apply to the Administrator of the OPA is made clear in the case of *Bowles v Griffin, supra*. All of the necessary elements of an estoppel are present in the instant case.

NEITHER THE APPELLANT NOR THE PUBLIC HAS SUFFERED ANY DAMAGE

The only parties who have suffered any damage in the matter of this alleged violation are the defendants, not the public.

The defendants started their business in December, 1943, and filed a pricing chart to which the appellant has no objection and concedes is correct.

During the first four months of their business they actually sold merchandise under these published ceiling prices (R. 58) which, of course, is not contrary to OPA regulations. Revised Maximum Price Regula-

tion No. 330, above referred to, provided the defendants should use sale prices of the first four months of their operation for their base instead of the published ceiling prices filed in December, 1943. Under the last OPA ruling they are bound with their generosity, but in no instance did the public pay a higher price than the defendants had a right to charge or would have had a right to charge had they not put their prices under their authorized ceilings during the first four months.

These last above mentioned facts clearly show that Revised Maximum Price Regulation No. 330 is arbitrary and discriminatory as it has the effect to force the defendants in this case to sell the same goods for less than their competitors can sell them, and could lawfully have hold them under OPA regulations.

The defendants are aware of the fact that they are in the wrong court to have the Revised Maximum Price Regulation No. 330 set aside on the grounds that it is arbitrary or discriminatory under §204(d).^{*} However, these facts are all contained in the record (R. 56, 57 and 58) and the conclusion is obvious.

CONCLUSION

The whole case turns on the proposition of whether the communications of September 14 and October 7, above referred to, were orders or opinions. There can be no question but that they were intended as orders when written, which then raises the question as to whether or not the Administrator can now say that since the orders were wrong they became opinions

which are not binding on the Administrator because the District Price Executive was not authorized to give an opinion. If the court decides these communications were orders, then the defendants urge the court that the Office of Price Administration is estopped to bring this action under the authorities above cited, and particularly the case of *Bowles v. Griffin, supra*, and the decision of the District Court should be affirmed.

Respectfully submitted,

MERRITT, SUMMERS & BUCEY

ROSCOE KRIER,

Attorneys for Appellees.

*Title 50 App. 924, §§(b) & (d) U.S.C.A.

No. 11,420

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

PHILIP B. FLEMING, Temporary Controls
Administrator,

Appellant,

vs.

DOROTHY HANSCOM and R. C. HANSCOM,
d/b/a Dorothy Hanscom's, a Copartner-
ship,

Appellees.

APPELLANT'S REPLY BRIEF.

WILLIAM E. REMY,

Deputy Commissioner of Price
Administration for Enforcement,

DAVID LONDON,

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Topical Index

	Page
Argument	1
Conclusion	6

Table of Authorities Cited

	Page
Aunt Jemima Mills Co. v. Rigney & Co., 247 Fed. 407, certiorari denied 245 U.S. 672.....	4
Bowles v. Griffin, 151 F. 2d 458.....	2
Euclid Doan Co., In re. 104 F. 2d 714, certiorari denied 308 U.S. 619	4
Fritch v. United States, 234 Fed. 608.....	4
Rosensweig v. United States, 144 F. 2d 30.....	6
Sturm v. Boker, 150 U.S. 312.....	4
Texas Co. v. Chicago & A. R. Co., 126 F. 2d 83.....	4
United States v. Denver & R. G. W. R. Co., 16 F. 2d 374....	3
United States v. Stewart, 311 U.S. 60.....	3
Yakus v. United States, 321 U.S. 414.....	6

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DOROTHY HANSCOM and R. C. HANSCOM,
d/b/a Dorothy Hanscom's, a Copartner-
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Appellees.

APPELLANT'S REPLY BRIEF.

ARGUMENT.

Appellees apparently concede the force of the cases cited by us, but seek to avoid their effect by referring to the mimeographed notices as "orders" instead of interpretations of the regulations. Appellees' contention that the mimeographed notices were orders is purely an assumption unsupported by any authority and negatived by the very wording of the mimeographed notices.

All that these notices did was to inform dealers that Revised Maximum Price Regulation No. 330 had been

issued and was in effect. It then advised these dealers what the Regulation prescribed with regard to the preparation and filing of a pricing chart. The opening language of the second paragraph is most significant: "According to this revised Regulation, it is necessary * * *." Finally, in the last paragraph, the dealers were advised that a copy of the revised Regulation would be sent to them by the local OPA board as soon as they received their supply.

Clearly, these notices cannot be construed as anything more than notification that a new Regulation has been issued and had been put into effect, and a further notification of one of the provisions of that Regulation. As such, the most that can be said of these notices is that they constituted an interpretation of what the Regulation provided with regard to the filing of pricing charts. Since these notices did not constitute official interpretations under the provisions of Sections 54 and 55 of Revised Procedural Regulations No. 1, appellees had no right to rely upon them. The authorities which we cited in our original brief are admittedly in point as to this proposition.¹

This brings us to the second or corollary contention of appellees, namely, that the Administrator was estopped from maintaining this action by reason of the notices.

¹In the *Griffin* case, the authority of the Rent Director as above disclosed, did not appear in the record. The Court, however, pointed out that both parties had conceded the authority of the Rent Director to issue the orders, and both parties relied upon the orders issued by the Rent Director.

It is a fundamental principle of our jurisprudence that the United States is neither bound nor estopped by the unauthorized acts of its officers or agents. This rule is so well settled as not to require the citation of the numerous cases in which it has been applied.

Typical of these cases is *United States v. Stewart*, 311 U.S. 60, where it was claimed that the defendant had relied on statements issued in circulars prepared and distributed by the Farm Loan Board. The Court said at page 70:

“An officer or agency of the United States to whom no administrative authority has been delegated cannot estop the United States even by an affirmative undertaking to waive or surrender a public right. *Utah v. United States*, 284 U.S. 534, 545, 546, 52 S. Ct. 232, 235, 76 L. Ed. 469; *Wilber National Bank v. United States*, 294 U.S. 120, 123, 124, 55 S. Ct. 362, 363, 364, 79 L. Ed. 798.”

Since the notices, whether considered as orders or as interpretations, were unauthorized,² no estoppel could result.

The cases cited by appellees on this proposition are not in point. In *United States v. Denver & R. G. W. R. Co.*, 16 F. 2d 374, the approval relied upon was given by the Secretary of Interior, and there was no claim made as to any lack of his authority to give

²By Amendment No. 7, effective June 15, 1946, District Offices were authorized to issue orders governing the pricing by retailers of price-maintained merchandise. That provision is inapplicable here, and became effective long after the period involved in this case.

such approval. In *Fritch v. United States*, 234 Fed. 608, also relied upon by appellees, the Court, in its opinion on rehearing (236 Fed. 133) recognized the rule that the government is not estopped by the unauthorized acts of its agents or officers, but pointed out that the Secretary of Commerce and Labor was acting within the scope of his authority. Clearly, these cases have no bearing on the case at bar.

There is another cogent reason why appellees cannot claim estoppel. An essential element of the right to claim estoppel is that "the party asserting estoppel must be able to show that he has been injured by the conduct of the other party and that he had no knowledge or means of knowledge of the truth". (*In re Euclid Doan Co.* (C.C.A. 6th), 104 F. 2d 714, 715, certiorari denied 308 U.S. 619.)³

The rule has been succinctly stated in *Texas Co. v. Chicago & A. R. Co.* (C.C.A. 7th), 126 F. 2d 83, where the Court speaking of estoppel said at page 91:

"It was never intended to work a positive gain to a party. See Notes, 17 Am. St. Rep. 24; 25 Am. St. Rep. 330. Its whole office is to protect him from a loss, which but for the estoppel, he could not escape. In other words, an estoppel should be limited to what may be necessary to

³Obviously, appellees had no right to rely on the notices when they could and should have looked to the Regulation to which their attention was called by the notices.

In any event, the notices, at most, were not expressions of fact, but of law. Such expressions do not make the law other than it is, or estop the appellant from relying on the law as it really is. *Aunt Jemima Mills Co. v. Rigney & Co.* (C.C.A. 2d) 247 Fed. 407, 409, certiorari denied 245 U.S. 672; *Sturm v. Boker*, 150 U.S. 312.

put the parties in the same relative position which they would have occupied if the predicate of the estoppel had never existed. *Phillipsburgh Bank v. Fulmer*, 31 N.J.L. 52, 86 Am. Dec. 193.”

Appellees have failed to show how they will be adversely affected if their claim of estoppel is disallowed. It must be remembered that all the Administrator seeks to recover by this action is the amount of the overcharges which appellees have received. No damages above that amount are sought. (R. 15.) If the Administrator is permitted to recover, the appellees will be in precisely the same situation that they would have been in if they had followed the Regulation instead of the notices.

Let us re-create the situation as it existed when Revised Maximum Price Regulation No. 330 was issued. Suppose the District Office had not sent out the mimeographed notices. The appellees would have been required to read the Revised Regulations and file a new pricing chart based upon deliveries of garments during the first four months following the first delivery of garments by them. This would be the pricing chart which they eventually did file as the amended pricing chart on November 26, 1945. (R. 9-10.) Had appellees done so and abided by that pricing chart, their customers would have paid appellees \$714.01 less than they did. Consequently, if appellees are compelled to pay to the Treasury of the United States the sum of \$714.01, it puts them in the same position that they would have been in had they followed the Regulation and had not been “misled” by the mimeo-

graphed notices. Conversely, if the appellees' claim of estoppel be sustained, the result would be a positive gain to the appellees, contrary to the purpose and function of the principle of estoppel.

In a futile attempt to show that they have been injured, appellees argue that the Revised Regulation is arbitrary and discriminatory because it compels them to sell at the same prices which they charged during the first four months of their operations—a period in which they sold at less than their allowable maximum prices. This contention does not aid the appellees. It does not show an injury resulting from appellees' following the notices. Rather, it is a result which follows from the Revised Regulation itself. Appellees' complaint then goes, not to the alleged estoppel, but to the validity of the Regulation itself—a complaint which, in view of the provisions of Section 204(d) of the Emergency Price Control Act, as amended (50 U.S.C. App. Sec. 924(d)), cannot be made in this Court. *Yakus v. United States*, 321 U.S. 414; *Rosen-sweig v. United States* (C.C.A. 9th), 144 F. 2d 30.

CONCLUSION.

Appellant respectfully submits that the contentions advanced by appellees in support of the judgment are without merit. The judgment below is clearly erroneous and should be reversed and the case remanded with directions to the lower Court to enter judgment

in favor of the plaintiff in the sum of \$714.01 and costs.

Dated, January 15, 1947.

Respectfully submitted,

WILLIAM E. REMY,

Deputy Commissioner of Price
Administration for Enforcement,

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IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

ALFRED SHYMAN, doing business under
the assumed name, business and style
of ALASKA DISTRIBUTORS COMPANY,
Appellant,

vs.

PHILIP B. FLEMING, Temporary Controls
Administrator, *Appellee.*

ON APPEAL FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE WESTERN DISTRICT OF
OF WASHINGTON, NORTHERN DIVISION

PETITION FOR REHEARING

FILED

SEP 12 1947

DANIEL B. TREFETHEN, *Attorney for Appellant.*
PAUL P. O'BRIEN, *Clerk*

1466 Dexter Horton Building,
Seattle 4, Washington.

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

ALFRED SHYMAN, doing business under
the assumed name, business and style
of ALASKA DISTRIBUTORS COMPANY,
Appellant,

vs.

PHILIP B. FLEMING, Temporary Controls
Administrator, *Appellee.*

ON APPEAL FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE WESTERN DISTRICT OF
OF WASHINGTON, NORTHERN DIVISION

PETITION FOR REHEARING

DANIEL B. TREFETHEN,
Attorney for Appellant.

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INDEX

	<i>Page</i>
1. Alaska Prices regulated by M.P.R. 194.....	2
2. Validity of formula not under attack; Appellant contends for necessity of written order fixing Seattle price	3
3. United States Constitution and Washington State statutes and regulations concerning liquor control set aside with no comment.....	5

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No. 11422

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PRELIMINARY

Since this Court seems to have made its determination upon most of the points included in Appellant's appeal, and appellant feels that it will be ineffectual to attempt to change such decision of this court in such respects, yet appellant hereby takes the liberty of calling to the attention of the Court again one or two matters which do not appear to have been noted fully in the Court's opinion.

1. ALASKA PRICES REGULATED BY M.P.R. 194

This Court says (page 2 of its opinion): "While appellant contends to the contrary, Maximum Price Regulation No. 194 (7 F.R. 971, 3663) is clearly inapplicable to the transaction." It should be noted that Footnote (2) was a part of the original No. 194, as adopted prior to January, 1943.

But the clause in Footnote (2) was superseded by an amendment No. 10 of M.P.R. No. 194 (adopted in January, 1943) wherein it states, "The provisions of this Maximum Price Regulation No. 194 *supersede* the provisions of all other maximum price regulations, except where other maximum price regulations provide that notwithstanding Maximum Price Regulation No. 194, such other regulations shall be applicable in the Territory of Alaska." This Amendment was filed with the Federal Register (F.R. Doc. 34-780) and was in force during the whole of the period (April, 1943 - September, 1943) in which the sales were effectuated by Appellant (defendant) to his Alaskan buyers.

In this connection it should be noted that neither Order No. 3 under M.P.R. No. 193, nor the 2nd Rev. Max. Exp. Price Reg. which Appellee (plaintiff) contends is the Order and Regulation — when properly interpreted — establishing that Appellant (defendant) made an alleged \$21,809.89 overcharge to his Alaska customers, contain any statement therein that "*such other regulation shall be applicable in the Territory of Alaska.*" Certainly no language can be clearer than the provision in M.P.R. No. 194, that

“the maximum price to a *buyer* in the Territory of Alaska shall be,” and the further requirement in Amendment No. 10, of M.P.R. No. 194, that such M. P.R. No. 194 “*supersedes the provisions of all other maximum price regulations.*”

Furthermore, this Court has entirely lost sight of the fact that the Maximum Price Regulation statutes were intended to regulate prices at the place of the market — in this case Alaska — and that ALL buyers of this merchandise from Shyman had their places of business in Alaska.

It having been conceded by Appellee’s counsel that there were no ceilings on Alaska merchandise, and this merchandise having been destined for the Alaska market at all times from the time of the beginning of the shipment in Minneapolis, Appellant still contends that the decisions of the United States Supreme Court are decisive on the question.

2. VALIDITY OF FORMULA NOT UNDER ATTACK; APPELLANT CONTENDS FOR NECESSITY OF WRITTEN ORDER FIXING SEATTLE PRICE

Appellant contends, further, that this court misconstrues Appellant’s argument concerning the fixing of a Seattle price upon this merchandise. Appellant is not attacking the validity of the formula in the Regulation. Appellant still insists that it was the duty of some O.P.A. official to enter A WRITTEN ORDER establishing a Seattle price for the goods. That is the procedure adopted by this Court in *Martini v. Porter*, 157 F.(2d) 35, which procedure follows exactly the basic law as promulgated by Congress. This court

therein said (page 40): "Before the district court could lawfully enter a judgment based on or involving the amount of overcharges, *it was necessary for the OPA to enter this order.*" So, again, may we reiterate that a *written order establishing Seattle prices must have been* entered by some authorized OPA official, before judgment rightfully could be entered in this case.

This court, in its opinion, assumes that "adequate avenues of relief were open to Appellant by application to the Administrator for an authoritative written interpretation." The procedure referred to applies only when some O.P.A. official somewhere has established a price and the protestant insists that another price should be established as the correct ceiling price. But, in this case, no ceiling price in Seattle had ever been established by any official and Appellant's letters could find no means of making any such official establish such a price by written order as the law requires. The "uncertainties" as to such price were for the O.P.A. officials to determine and establish, and were not to be the action of Appellant under the law.

This court states that Appellant "concededly paid above ceiling prices to his suppliers." In such respect this Court is in error. Until a selling price had been established at Seattle by the O.P.A. by a written order, there was no "over-ceiling price violative of the law."

3. UNITED STATES AND WASHINGTON STATE STATUTES AND REGULATIONS CONCERNING LIQUOR CONTROL SET ASIDE WITHOUT COMMENT

This court has failed in its opinion to notice that both the United States Constitution as interpreted by the United States Supreme Court, and the statutes and liquor regulations of the State of Washington, provide that there can be no “domestic” sale of liquors in the State of Washington. Particularly, it should not be the law that by an *oral* interpretation of some O. P.A. official such liquor control of the state may be set aside by the O.P.A.

Furthermore, the Court has not exercised its chancellory powers herein, to right the wrong where an \$18,020.25 loss due to admittedly—and not denied—wrong pricing methods of an O.P.A. official has caused an extreme hardship to this Appellant of whom the lower court stated that he had exercised the greatest good faith in trying to comply with O.P.A. statutes and regulations.

Because of lack of time to include additional authorities herein, Appellant respectfully prays this Court for an additional 15 days within which the decisions of other courts applicable to Appellant’s contentions may be presented to this Court; in particular, such decisions as may appertain to an equitable method of adjusting the judgment in this case to the concededly good faith of all of Appellant’s desires to conform to the complex rules and regulations of the O.P.A.

Respectfully submitted,

DANIEL B. TREFETHEN,
Attorney for Appellant.

VERIFICATION

STATE OF WASHINGTON, COUNTY OF KING—SS.

Daniel B. Trefethen, being first duly sworn, on oath, deposes and says as follows: That affiant is attorney for Appellant Alfred Shyman who is absent in Alaska; that affiant is personally familiar with all of the matters and statements set forth in the foregoing Petition for Rehearing; that he executes this verification as the act and deed of said Appellant Alfred Shyman for the uses and purposes therein stated, being authorized so to do; that he has read said Petition, knows the contents thereof and the same are true as he verily believes.

Daniel B. Trefethen

Subscribed and sworn to before me this 12th day of September, 1947.

Geo. P. Hendrix

Notary Public in and for the State of Washington, residing at Seattle.

CERTIFICATE OF COUNSEL

As counsel for Alfred Shyman, Appellant in the above Petition for Rehearing, I hereby certify that in my judgment the Petition is well founded and that it is not interposed for delay.

Daniel B. Trefethen

DANIEL B. TREFETHEN,

Attorney for Appellant.

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ADDITIONAL AUTHORITIES

FILED

OCT - 1 1947

PAUL P. O'BRIEN,

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INDEX

	Page
1. Alaska Prices regulated by M.P.R. 194.....	1
2. Validity of formula not under attack; Appel- lant contends for necessity of written order fix- ing Seattle price	5
3. United States Constitution and Washington State statutes and regulations concerning liquor control set aside with no comment.....	27

TABLE OF CASES

<i>Addison v. Holly Frost Products</i> , 322 U.S. 607 at 618 (6)	43
Anchorage Grocery 3 Pike & Fisher O.P.A.....	5
<i>Bowles v. Simon</i> , 145 F.(2d) 334 at 336-337.....	20
<i>Brown v. Wyatt Food Stores</i> , 49 F. Supp 538.....	19
<i>Carter v. Commonwealth of Virginia</i> , 321 U.S. 131 at 137-138.....	39
<i>Case v. Bowles</i> , 327 U.S. 92 at 98.....	12
<i>Case v. Bowles</i> , 327 U.S. 92 at 98 (7).....	42
<i>Ch., Mil. St. P. Ry v. Pub. Util. Com.</i> , 274 U.S. (71 L. ed.) 1085 at 1090.....	42
<i>Collins v. Fleming</i> , 159 F.(2d) 431 at 437, 438, 439	16
<i>Collins v. Fleming</i> , 159 F.(2d) 431 at 437-439.....	37
<i>Collins v. Porter</i> , 328 U.S. 46 at 48 (1, 2).....	12
<i>Conklin Pen Co. v. Bowles</i> , 152 F.(2d) 764 at 766 (4, 5)	22
<i>Duckworth v. State of Arkansas</i> , 314 U.S. 390, at 398, 399	40
<i>Fleming v. Moberly Milk Products Company</i> , 160 F.(2d) 259, at 264-266.....	22

TABLE OF CASES

	<i>Page</i>
<i>Fleming v. Van Der Loo</i> , 160 F.(2d) 906 at 911, 912, 913	34
<i>Gordon v. Bowles</i> , 153 F.(2d) 614 at 615 (1, 3) 616	22
<i>Hamilton v. Kentucky Distilleries & Warehouse Company</i> , 251 U.S. 146 at 155.....	42
<i>Hoover & Allison Company v. Evatt</i> , 324 U.S. 652 at 673-674 (18, 19, 20).....	3
<i>Indianapolis Brewing Company v. Liquor Control Commission</i> , 305 U.S. 391 at 394.....	38
<i>International Shoe Company v. State</i> , 22 W.(2d) 148, Aff. by U.S. Supreme Ct. 66 Sup. Ct. 154, at 157-161	4
In re Otto Kraft & Sons 3 Pike & Fischer, O.P.A. Opin. & Dec. 223- 224	5, 11
<i>Joseph S. Finch & Company v. McKittrick</i> , 305 U.S. 395 at 397, 398.....	38
<i>W. J. Lake & Co. v. King County</i> , 3 Wn.(2d) 500, Rehearing 4 Wn.(2d) 651 Cer. denied 311 U.S. 715	4
<i>Mahoney v. Joseph Triner Corporation</i> , 304 U.S. 401, at 403-404.....	38
<i>Martini v. Porter</i> , 157 F.(2d) 35 at 40.....	7, 16
<i>Norwegian Nitrogen Prod. Co. v. U. S.</i> , 288 U.S. 294 at 318	20
<i>N. P. Ry. v. Dept. of Pub. Wks.</i> , 268 U.S. (80 L. ed.) 836 at 839	42
<i>State Board of Equalization v. Youngs Market, Inc.</i> , 299 U.S. 59 at 62-64.....	38
<i>Swan & Finch Co. v. U. S.</i> , 190 U.S. 143 at 144- 146	3

TABLE OF CASES

Page

<i>Supak v. Porter</i> , 158 F.(2d) 803 at 806 (6, 7).....	6
<i>Thomas Paper Stock Co. v. Porter</i> , 328 U.S. 50 at 54-55	24
<i>Utah Junk Co. v. Porter</i> , 328 U.S. 39 at 44 (2) (3)	26
<i>F. Uri & Co. v. Bowles</i> , 152 F.(2d) 713 at 715, 718	23
<i>U. S. v. Frankfort Distilleries</i> , 324 U.S. 293 at 301	40
<i>U. S. ex rel Porter Adm. v. Kroger Grocery & Bak- ing Company</i> (Decided by C. Ct. of Ap. 7th Cir. Aug. 15, 1947)	35
<i>U. S. v. Johnson</i> , 53 F. Supp. 170-173.....	17
<i>Van Der Loo v. Porter</i> , 160 F.(2d) 110 at 112.....	22
<i>Washington Brewers Institute v. U. S.</i> , 137 F.(2d) 964, at 966-968.....	41
<i>Western Union Tel. Co. v. Lenrost</i> , 323 U.S. 490 at 508 (10)	4
<i>Williams v. Kaiser</i> , 323 U.S. 471 at 478 (i).....	4
<i>Yakus v. U. S.</i> , 321 U.S. 414, 431.....	12
<i>Ziffrin v. Reeves</i> , 308 U.S. 132 at 140 (12).....	41

STATUTES AND TEXTBOOKS

M.P.R. No. 194.....	1
M.P.R. No. 194, Amt. 12.....	25, 27
17 Opinions U.S. Atty.-Gen.....	3
Century Dictionary.....	2
Standard Dictionary.....	2

O.P.A. OPINIONS AND DECISIONS

Opinion of Chester Bowles	
3 O.P.A. Opin. & Dec. 303 at 304.....	21
3 O.P.A. Opin. & Dec. 156-157.....	11

EXHIBITS

Shyman's Ex. S.1.....	25
S.7.....	25
S.8.....	12
S.9.....	12
S.16.....	8
S.17.....	8
S18.....	8
S.20.....	9
S.22, p. 93, 94.....	34
S.23 J.....	35

(Wash. State Liquor Control Board Phamphlet.)

IN THE
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ON APPEAL FROM THE DISTRICT COURT OF THE
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PETITION FOR REHEARING

ADDITIONAL AUTHORITIES

In this supplemental argument designating additional authorities the points will be numbered to conform to those set forth in Appellant's Petition for Rehearing.

1. (Petition for Rehearing, pages 2-3.)

In its opinion this court has stated that M.P.R. No. 194 "is clearly inapplicable to this transaction" because a) "export" is described by the Regulation as "any sale of a commodity by a seller * * * in the continental United States to a purchaser outside thereof" (Note 1, page 2, of the Opinion); and b) "sales and

deliveries to a *buyer* in the Territory of Alaska do not include sales from a seller outside of the Territory of Alaska to a purchaser in the Territory of Alaska" (Note 2, page 2, of the Opinion)

a) It has always been the usage of the United States Customs Department *not* to include the shipment of commodities to Alaska in the "export" classifications. All dictionaries, likewise, designate the word "export" to mean otherwise than the definition applied to Alaska by this court.

The Century Dictionary: Export to means "to carry or to take away; specifically—to send (ocommodities) *to other countries* for sale or exchange. Exportation—the act of exporting; the sending of commodities *out of a country* in trade. The Standard Dictionary defines Export to mean "to carry or send out or away, especially for trade from one country to another. Export—that which is exported; in general, goods or any article of trade or merchandise sent from one country to another; properly, *and as used in the United States Constitution*, goods sent to a foreign country; usually in the plural, as, Exports to Europe. Exportation—The act or practice of exporting, or of sending out commodities from *one country to another* for traffic or sale. Exporter — One who exports—especiallly, one whose business it is to send goods *by way of trade to another country* or region. Custom—A tariff or duty assessed by law levied upon goods exported or imported. Phrases: Customs duty, the tariff or tax assessed upon merchandise imported from or exported to a *foreign country*.

“Whatever primary meaning may be indicated by its derivation, the word ‘export’ as used in the Constitution and laws of the United States, generally means the transportation of goods from this *to a foreign country*. As the legal motion of emigration is a going abroad with an intention of not returning, so that of exportation is a severance of goods from the mass of things belonging to this country with an intention of uniting them to the mass of things belonging to some foreign country or other.”

17 Op. U. S. Attys. Gen. 583.

In this connection the United States Supreme Court confirms such definition wherein it states:

“But, if the question were one of doubt, the doubt would be resolved in favor of the importer ‘as duties are never imposed on the citizen upon vague or doubtful interpretations.’”

Swan & Finch Co. v. U.S., 190 U.S. 143, at 144-146.

The Territory of Alaska belongs to the United States but is not a part of the Union of States under the Constitution * * *. The Constitutional restrictions on the power of Congress to deal with articles brought into or sent out of the United States do not apply to articles brought into or sent out of the “Territory.”

Hoover & Allision Company v. Evatt, 324 U.S. 652, at 673-674 (18.19, 20).

It was an “established business practice” since 1933, that whiskey sent to Alaska was not an “export” and such clause should not be interpreted so as “to compel changes in the business practices, * * * established in

an industry” (Emergency Price Control Act of 1942, Sec. 2(h) (Public Law 421, 77th Congress, Chap. 26, 2nd Session, H.B. 5990).

The business practices of this defendant were a direct issue in the *Lake* case and were confirmed by the business practices recited in the *International Shoe Company* case.

W. J. Lake & Co. v. King County (Alaska Distributors, as *Amicus Curiae*) 3 Wn. (2d) 500, rehearing 4 Wn.(2d) 651, certiorari denied, 311 U.S. 715.

International Shoe Company v. State, 22 Wn. (2d) 148; affirmed by U.S. Supreme Court, 66 Sup. Ct. 154, at 157-161.

The above cases should be binding upon this court.

Williams v. Kaiser, 323 U.S. 471 at 478(i).

b) The Administrator rightly designated that his Regulation No. 194, Amendment No. 10, was the sole regulation applying to sales to *buyers* in Alaska unless any regulation applicable in the United States contained the saving clause “that such prices should apply to Alaska.” Regulation No. 193 had no such saving clause, as was demonstrated in the Petition for Rehearing (pp. 2-3). As the Supreme Court has stated, “It is beyond the judicial power of innovation to supply a direct prohibition by construction. We think we should not try to reach the same result by a series of interpretations so far fetched and forced as to bring into question the candor of Congress as well as the integrity of the interpretative process.”

Western Union Tel. Co. v. Lenrot, 323 U.S. 490 at 508(10).

That Regulation No. 194 is applicable to this case is established furthermore by the Opinions rendered by Administrator Chester Bowles:

In the Matter of the *Anchorage Grocery, et al.* Order denying protest. Docket No. 1288-2-P, issued April 8, 1945, and published in Vol. 3, Pike & Fischer's O.P.A. Opinions and Decisions at pages 156-157;

In the Matter of *Otto Kraft & Sons.* Opinion denying protest. Docket No. 1288-3-P, rendered May 12, 1945, and published in Vol. 3, Pike & Fischer's O.P.A. Opinions and Decisions at pages 223-224.

As recited in said Opinions of Administrator Chester Bowles, there were no ceiling prices on Tom Burns Whiskey in Alaska until the Amendment of Regulation No. 288 was adopted in April, 1944, practically a year subsequent to the sales consummated in this case (Shyman's Ex. S.1, Amendment 12).

II. (Petition for Rehearing, pages 3-4) :

Evidently Appellant's counsel did not make clear to this court that his insistence upon the establishment of a ceiling price for Tom Burns Whiskey *in Seattle by a written order*, did not constitute an attack upon the validity of Order No. 3 under M.P.R. 193. Appellant never has insisted that "the Administrator was without power to establish maximum prices by formula" (Opinion, pp. 2-3).

Counsel for Appellant is not questioning the validity of *any* Regulation. It is true that the Emergency Court of Appeals has the jurisdiction to determine the validity of regulations and not this court. *But Appellant in-*

sists that the applicability of certain Orders or Regulations as opposed to other Orders or Regulations, and interpretations of the language of the applicable Regulations, are matters for the determination of this court in this proceeding.

May we re-examine for the court some of the pertinent facts in this case. No written order of any kind has *ever* been made by any O.P.A. official establishing a price for Tom Burns Whiskey in Seattle. Appellant's contention herein is that establishing a maximum price for Tom Burns Whiskey in Minnesota (under Order No. 3, O.P.R. 193) has no applicability as to maximum prices for such whiskey either in Seattle or in Alaska. There must have been a further order issued by some O.P.A. authorized official fixing dollars and cents values for the whiskey. It must be affirmatively proven by the Administrator that he properly ascertained and worked out the formula (method) by applying the dollars and cents costs of freight and other expenses designated in the order and that the resultant effect was a designated dollars and cents value for Seattle in writing by an authorized official. As stated, no such order *by any official was ever issued* as to the price of Tom Burns Whiskey in Seattle, or in Alaska.

The Emergency Court of Appeals has enunciated the law that prices may vary in the same commodity in various localities throughout the United States and its possessions.

Supak v. Porter, 158 F.(2d) 803 at 806, 7).

This court says (Opinion, page 3) that "It is claimed, also, that the formula prescribed was so vague and complex that appellant was unable to ascertain the applicable ceiling prices for his product." Not only was the Minnesota formula (Order No. 3) under M.P.R. 193 "vague and complex" to appellant, but the formula could not be worked out intelligently by *any* O.P.A. official who tried to do so. The oral interpretations of different O.P.A. officials made a variance as to the alleged ceiling price at Seattle, ranging from an overcharge of \$53708.48 down to \$21809.89, according to the testimony. Even the enforcement attorney who commenced the action was \$10000 over the alleged ceiling price, and the testimony of the O.P.A. official upon the witness stand showed that he was in error by \$2,000, if another factor in the formula was interpreted differently (Appellant's Brief, p. 37). Appellant's testimony showed that, rightly interpreted, there was an under charge of \$20745.38 under the alleged ceiling price (Appellant's Brief, pp. 42-43). Admittedly, then, such "vague and complex" formula should have been interpreted by some authorized official of the O.P.A. by some form of written order, in accordance with the holding of this court in the *Martini* case (*Martini v. Porter*, 157 F.(2d) 35 at 40).

But, says this court, "there were adequate avenues of relief open to him (Appellant) by application to the Administrator for an authoritative written interpretation, or for an adjustment. Appellant resorted to none of the available methods of dispelling his uncertainties."

May we respectfully refresh the memory of the court. As to an "authorative written interpretation," Appellant did everything possible to obtain such an interpretation. On October 7, 1943, a letter was written to the Beverage Division in Washington, D. C., wherein Appellant requested an opinion about the "pricing of Tom Burns Whiskey for shipment to Alaska." To this an answer was received "Prices covering such shipments were established *under an interpretation issued by the Seattle office*" (Shyman's Exhibit S.16). This letter was signed by E. G. Even, head, Beverages and Imported Foods Section, Food Price Division.

Inquiry to the local enforcement officer of the O.P.A. concerning such interpretation caused Appellant's counsel to write again to the Beverage Division at Washington, D. C., to "furnish the information desired by me, as to the items making up the ceiling prices for Tom Burns Whiskey in Alaska, * * * kindly give me the formula followed by your office, * * * will you kindly inform me when such ceiling prices were established * * * (Shyman's Ex. S.17). An answer from the same E. G. Even stating that such information "could best be secured from our O.P.A. office in Seattle. * * * We feel, therefore, that any information relative to that interpretation should be issued by the *originating office*" (Shyman's Ex. S.18).

Consequently, on October 18, 1943, a letter was sent by Appellant's attorney to the local enforcement attorney in which it was stated "Inquiry of Hon J. B. Sholley, Price attorney in Seattle of the O.P.A., revealed that, so far as he knew, the Seattle office had"

no written regulation or order on file establishing such prices. * * * Inquiry of Hon F. R. Burries, enforcement officer of the O.P.A., reveals that there is no written ruling or regulation in the Seattle office establishing such prices. * * * That the items of the formula by which said ultimate ceiling prices were worked out were unknown to the Seattle officials of O.P.A. * * * There may be an error in such prices, but such error cannot be ascertained until the items used by your Department in following the formula set up in the O.P.A. Refutations are made known to us. Consequently, may we respectfully request such items. * * * Or, if you cannot give us such items, will you kindly give us the information as to what officials in Washington, D. C., to whom we should write in order to obtain the costs going into such designated prices (Shyman's Ex. S.19).

No answer having been vouch-safed to such request, a letter was written to Hon. Arthur J. Kraus, Director of the Seattle Office of the O.P.A., on November 26, 1943 (Shyman's Ex. S.20) in which the request for items of the formula recited:

November 26, 1943

"Hon. Arthur J. Kraus
Director, Office of Price Administration
White-Henry-Stpart Building
Seattle 1, Washington.

In re Alaska Distributors Co.
Refer to 21973 (JSA:fc(2))

Dear Sir:

Since August, 1943, I have been endeavoring to obtain from officials in the local Office of Price

Administration, in writing, the different items of the formula upon which are based the ultimate ceiling prices in Alaska of \$29.40 per case of fifths, \$35.77 per case of quartes, and \$36.52 per case of pints, for Tom Burns Whiskey, for sales occurring prior to August 31, 1943.

According to the computation as worked out by Mr. J. B. Sholley, and conveyed to me orally, the above stated prices are the established ceiling prices. According to officials in the Enforcement office of the O.P.A. such figures are not accurate. I have endeavored to work out a price upon the formula as orally stated to me, and my figures differ from those of both officials. Heretofore, I have always assumed that the price hereinabove set forth — \$29.40 for fifths, \$35.77 for quarts and \$36.52 for pints—were correct.

Since officials at Washington, D. C., state that the Alaska prices on Tom Burns whiskey 'were established under an interpretation issued by the Seattle office' may I, again, respectfully request from your office the date when such interpretation was made, by whom and where it was made, the figures constituting the formula whereby such ceiling prices were arrived at, and where and when in your office an interested party could have ascertained that such ceiling prices were established and the written memoranda covering such essential information.

Since any suggested compromise in this case involves exact computation of a considerable sum of money, as well as being essential in other pending litigation with another distributor in the State Courts, may I again respectfully request

the furnishing in writing of the essential information hereinbefore requested.

Respectfully,

DANIEL B. TREFETHEN,
Attorney for
Al Shyman d/b/a
Alaska Distributors Co.”

No answer to such inquiry was ever received. In this connection it should be noted that there are no forms wherewith an “authoritative written interpretation” may be obtained. As to an “adjustment,” an eight-page letter offering \$30233.45 as an “adjustment” for an alleged overcharge was merely answered by a return of the check; no information as to the detailed ceiling prices on *any* alleged overcharge was ever received from any O.P.A. official in writing. What more can this court suggest should have been done by Appellant?

This court should also note, factually, that the conditions in the greater part of Alaska are such that for only a few short months can commodities be shipped to Alaska. Thus, Alaska distributors and buyers must accomplish in a short season what can be done throughout the year in the continental United States. On account of such conditions, the price situation had to be handled differently as shown by the decisions of the Administrator in the *Anchorage Grocery Co.* and *Otto Kraft & Sons* cases (Appellant’s Brief, p. 29).

This court states that “written interpretations” must be obtained. Such interpretations as to “acquisi-

tion cost" were obtained (Shyman's Exs. S.7, 8, 9), and were being acted upon, such interpretations being in line with the trade practices established since 1934. Nothing more could have been done, than was done by Appellant in this case, to comply with the intricacies and complexities of the O.P.A. Regulations. So much for the facts.

As to the law, the Supreme Court has ruled that even if a challenged regulation has been rightfully appealed to the Emergency Court of Appeals, that court should "refuse to pass on the applicability of the regulation to the petitioners." It left "that question to the District Court before which the treble damage suit is pending" (48, (1, 2). * * *

"The two modes of securing a hearing on the validity and applicability of the price regulation are cumulative and not alternative." (49 (3, 4))

Collins v. Porter, 328 U.S. 46 at 48 (1, 2).

This court can pass on the validity of the act of Congress which made the Regulations effective retroactively.

Case v. Bowles, 327 U.S. 92 at 98, 66 Sup. Ct. 438;

Yakus v. U.S., 321 U.S. 414, 431, 64 Sup. Ct. 660.

The Emergency Court, to whose decisions this court should defer, has held

"In the present case the complainants did not attempt to determine their maximum prices under Section 1499.3(c). Instead, they sold their whiskey at prices which the Price Administrator

in the treble-damages suit contends were in excess of the maximum prices established by M.P.R. 193 for their most closely competitive sellers of the same class, if any, and in any event were higher than the level of maximum prices established by that regulation for their commodity. Having thus failed to take advantage of the procedure which was open to them for obtaining a prior precise determination of their maximum prices *they have left open in the enforcement suit in the district court the determination of their proper maximum prices under the regulation.*

“We thus come to the final question in the case. Is the determination of the complainant’s in-line maximum prices for the sales which they made in January, 1943, and which are involved in the treble-damages suit in the United States District Court for the Western District of Kentucky to be made by that court in adjudicating that suit or is the determination of those prices which the Price Administrator has made by Order No. 45 valid and, therefore, binding on the district court under Section 204(d) of the Emergency Price Control Act? To put it another way, may the Price Administrator by an order directed solely to *that end determine the ceiling prices applicable to particular past sales* which are the subject of an enforcement suit *brought by him in a district court where one of the issues before the court is the amount of the proper ceiling prices applicable to the sales?*

“(2) As we have seen, Order No. 45 was directed solely to the past. Its object was to determine exactly for the purpose of computing damages in the enforcement suit of the maximum prices for complainants’ sales which Section

1499.3 of the GMBR (as incorporated by reference in Section 1420.13(c) of MPR 193) imposed upon them. * * * Here, however, the complainants did not request the Price Administrator to act but left the question of their maximum prices wholly open for judicial determination. The sole purpose of the order, therefore, was to adjudicate a question which the Price Administrator by instituting the triple-damage suit, had himself previously committed to the district court. We think that the Price Administrator was without power to make a determination, through the medium of what purported to be a retroactive price order, of the question thus committed to the district court."

"The price regulations and orders authorized to be issued by the Price Administrator under Section 2 of the act, 50 U.S.C.A., Appendix 902, and which are incontestable in the district courts under Section 204(d) are limited to those which will effectuate the purposes of the act. Order No. 45 did not effectuate any one of those purposes, however."

"Since its only object was to liquidate the damages in a pending suit between the Price Administrator and a group of alleged over-ceiling sellers it could only derive its authority from the act if one of the purposes of the act was to authorize the Price Administrator to decide issues of fact with respect to past transactions which he himself has already committed to a court of adjudication. We are satisfied that Congress had no such purpose in mind in passing the act and it is most doubtful whether Congress could have so provided if it had desired to do so. For, as we recently had occasion to say in *Lee v. Fleming*

(Em. App. 1946) 158 F.(2d) 984, 'such action would not only appear to involve the usurpation of judicial power which is vested in the courts alone, but would also *clearly be at war with the fundamental concept of due process of law that parties to controversies are entitled to have them determined by an impartial tribunal.*

"The question to which Order No. 45 is directed, the level of maximum prices established by MPR 193 for the bulk whiskey, is a factual one with which the district court is quite as competent to deal as is the Price Administrator. Indeed, it is just the sort of problem with which courts are called upon to deal every day and for the solution of which the judicial process is designed. The question is not a legislative one nor has Congress committed it to the exclusive determination of the Price Administrator. *On the contrary the Price Administrator himself has committed it to the district court by instituting the treble-damages suit in which it is a major issue.*

"For the reasons stated we conclude that Order No. 45 is not in accordance with law and is, therefore, invalid. It accordingly becomes unnecessary for us to discuss the other questions raised by the complainants. * * * A judgment will be entered declaring that Order No. 45 issued on June 13, 1945, under Section 1499.3(c) of the General Maximum Price Regulation was invalid from the date of its issuance." * * *

(On Rehearing):

"We held that Order No. 45 was neither authorized by Section 1499.3(c) of the General Maximum Price Regulation, under which it purported to be issued, nor by Section 2 of the

Emergency Price Control Act, 50 U.S.C.A., Appendix 902, which gives general authority to the Price Administrator to issue price orders, and that Order No. 45, was therefore invalid. We do not regard Section 1499.3(c) of the GMPR *as authorizing or contemplating a retroactive price order of the character of Order No. 45 to be made by the Price Administrator in the absence of an application by a seller.* Whether the regulation authorizes such an order to be made upon application of the seller is a question not before us. * * * It was, as we have just stated, that the order was invalid because it was not authorized by the regulation or the act. Objections upon this ground were clearly stated in each of the protests. It is true that we suggested that if the act had authorized such an order as Order No. 45 it might *well have been unconstitutional as involving usurpation of judicial power but our conclusion was that Congress had no such purpose in mind in passing the act.*

Collins v. Fleming, 159 (F.(2d) 431 at 437, 438, 439.

The foregoing decision is important in two respects: (1) It establishes that it was the Administrator's own opinion that an order establishing dollars and cents prices at the place of sale was a necessity — which is Appellant's contention herein. (2) It seems to be at variance with this court's decision wherein an ex post factor order establishing prices was upheld.

Martini v. Porter, 157 F.(2d) 35, 40.

In a case where the facts are somewhat similar the court has held:

*"Since the Act and the regulation do not establish any specific ceiling price for the commodity sub judice, defendants are entitled to know not only what the government claims the ceiling price to be, but also the manner in which it arrived at this conclusion. It may be that the government's method of calculation is erroneous. If so, defendants should have the opportunity to challenge this defect if, in fact, it exists. * * **

*"If the government erroneously computed the ceiling price, defendants should have the opportunity to object to such error without the necessity of standing trial. * * **

*"We do not know how the ceiling price was computed by the draftsmen of the indictments. Defendants, therefore, have no means of testing the accuracy of the pleaded conclusion that the ceiling price, for the transactions occurring subsequent to April 22, 1943, was any particular figure. * * **

" * * Since no ceiling price is fixed in Regulation 269, the indictment must show how the grand jury arrived at the ceiling price for the particular defendant for, as I said before, a defendant should be permitted to take advantage of a faulty calculation before trial and consequently he should be informed of all material elements that go to make up the crime. I accordingly refuse to alter the result of my original opinion."*

United States v. Johnson, 53 F. Supp., pp. 170, 171, 172, 173.

"There are two roads pointed in this statute. One is for the citizen in his protest, and his rem-

edy. That road leads to the Emergency Court at Washington, and to the Supreme Court. *The other road is for the use of the Administrator. He enters court against the citizen. That court is neither the Emergency Court nor the Supreme Court. It is any state or national court which has jurisdiction of the controversy. It is the local court. That is the road upon which the parties arrive here.* * * *

“The general authority given to the Administrator to make regulations is that they shall be ‘Generally fair and equitable’.” * * *

“The defendant in accepting battle where it was begun by the complainant, does so by stating that the Administrator is seeking to enforce regulations that are not ‘generally fair and equitable.’ That there is another provision of the Act which vests ‘exclusive jurisdiction’ in the Emergency and Supreme Court to pass upon the ‘validity’ of regulations, and to stay orders made by the Administrator, is not a sufficient answer nor a sufficient program as to what shall take place in and upon this voyage.” * * *

“Whether the defendant shall get anywhere in its attack upon regulations made by the Administrator for the defendant’s business, is beside the question. We do not need to argue that one may not enter court until he has exhausted his administrative remedy. *We all know that.* The requirement for such entry is no novelty.” * * *

“We must bear in mind that the litigation as to jurisdiction of other courts to do what the Emergency Court and the Supreme Court is given the power to do, does not limit the trial court upon the second road, to *require the Administra-*

tor to make out his case before he shall be entitled to restrain the citizen. In the making of that case, the citizen has his rights. He is called into court.

* * * * *

“The only way to give the citizen such right is to preserve his right to plead and to present his testimony and then to determine whether he is correct, or, whether the plaintiff is correct. * * *

“One may conceive of such a lack of ‘equity’ as to deny the complainant the restraint he prays, and yet in no way interfere with the ‘validity’ of a regulation. * * *

“Upon argument in open court, it was contended that certain errors had been made by the Administrator as to bacon, which the later corrected. That certain errors had been made with reference to tea by itself, and tea with a glass, and that certain mistakes had been made concerning the sales of bread. * * *

“That is the sort of inquiry that the court permits under the general idea and the prominent requisite that a regulation must be ‘fair and equitable.’ Equity being the overhead dominant as to both the plaintiff and the defendant in this suit.” * * *

Brown v. Wyatt Food Stores, 49 F. Supp. 538.

“We think counsel’s zeal and enthusiasm for the sanctity of such interpretations are hardly warranted. This doctrine would relegate the statutes of Congress to an inferior position unjustified even in these times when the compulsion

*of an emergency compels us to clothe administrative agencies with extraordinary powers. * * **

“(1) We do not accept the Administrator’s view that he may promulgate a regulation and then place on it an interpretation which becomes controlling on the courts. The Administrator has not grown to any such stature. The courts may consider his interpretations and follow them, if correct, but the court is not bound to follow them.” *Norwegian Nitrogen Products Co. v. United States*, 288 U.S. 294, 325, 53 S. Ct. 350, 77 L. ed. 796; *Bowles v. Nu Way Laundry Company*, 10 Cir., 144 F.(2d) 741. * * *

“(2-4) We think the District Court had a right to determine the meaning of these regulations for itself, although it could not, and did not, undertake to pass upon their validity, since that authority resides in the Emergency Court of Appeals and in the Supreme Court. Section 204, Emergency Price Control Act 1942, 50 U.S.C.A. Appendix §924. Having made its own interpretation, the District Court was justified in rejecting the Administrator’s interpretation of these regulations.”

Bowles v. Simon, 145 F.(2d) 334 at 336-337. (Cir. Ct. of App. 7th Cir.)

“Misinterpretation of regulations by the Administrator need not be followed by the courts. particularly if they are merely arbitrary edicts of the Department.”

Norwegian Nitrogen Prod. Co. v. U. S., 288 U.S. 294 at 318 (77 L. ed. 796 at 809.)

It should be noted that our actions in requesting

information followed the procedure directed by the Administrator himself.

“At the outset Protestant had available to it an alternative other than an attack on the validity of the regulation. *It could have requested that the Administrator, or one of his subordinates authorized to make interpretations, interpret the regulation so as to enable Protestant to know whether it applied to its sale, and how, if it did apply, its maximum prices were to be determined. This appears to be the most reasonable procedure when doubt exists in a seller’s mind.* A seller may, of course, have no doubts, having satisfied himself by a reading of two regulations as to which is applicable to him. In that case he is at liberty to argue the correctness of his interpretation, and possibly, as in Protestant’s case, to persuade a court having jurisdiction of an enforcement action.

“Where the Administrator had issued an order under M.P.R. No. 188 instead of under General M.P.R. *‘it is still open to the Protestant to challenge in the pending enforcement action, the Administrator’s interpretation.’*”

Opinion of Chester Bowles, Adm., P. & F. O.
P. A., Opinions and Decisions Vol. 3 p. 303
at 304.

The Emergency Court of Appeals holds “We have decided that where a District Court in an enforcement proceeding has interpreted a regulation as being applicable * * * we must *accept the District Court’s interpretation.*”

Van Der Loo v. Porter, 160 F.(2d) 110, at

112. (1). (Emergency Court of Appeals, September 5, 1946.)

Conklin Pen Company v. Bowles, 152 F.(2d) 764 at 766 (4, 5).

“The propriety of the classification as a matter of fact and the interpretation of the regulations are questions for the enforcement court; as to them we refrain from gratuitous expression of opinion.”

Gordon v. Bowles, 153 F.(2d) 614, at 615. (1-3), 616.

With respect to the doctrine that “Congress was satisfied that ample safeguards against arbitrary exercise of the allocation powers would be afforded by procedures within the administrative agencies themselves (264), the coordinate District of Columbia Court of Appeals has stated “If applied to a specific Congressional prohibition, that doctrine would spell executive absolutism, a concept unknown to our law * * * if the judiciary has no power in such matter, the only practical restraint would be the self restraint of the executive branch. Such a result is foreign to our concept of the division of powers of the government.”

Fleming v. Moberly Milk Products Company, 160 F.(2d) 259 at 264, 265, 266.

In the footnote (13) of the foregoing case, an extended quotation of legal authorities, upholds the legal doctrine “whether the agency acts within the authority conferred or goes beyond it, whether there is compliance with the legal requirements which fix the prov-

ince of the agency, are appropriate questions for legal decision.”

Fleming v. Moberly Milk Products Co., 160
160 F.(2d) 259 at 265. (Footnote 13)

In its opinion (p. 3) this court says Appellant “concededly paid above-ceiling prices to his suppliers” * * * “It seems plain that the phrase ‘the price at which the commodity was acquired’ can not fairly be construed to include an over-ceiling price. * * * The rational interpretation of the provision is that it has reference to an acquisition cost not violative of law.”

With respect to such statements, may we, respectfully, be not too technical in stating that we are not charged in the complaint with “purchasing over the ceiling price.”

However, Appellant has attempted herein to show that no suppliers over ceiling price was established in Seattle by any written order in this case, nor by any interpretation of any authorized O.P.A. official.

Appellee made reference to an obscure “interpretation” made in November, 1942, that no such “illegal” price cuold be paid. But it is significant that no order or regulation to that effect was ever made by the Office of Price Regulation and without such an order or regulation—necessarily publishable in the Federal Register—the interpretation has no binding effect according to the decision of this court.

F. Uri & Co. v. Bowles, 152 F.(2d) 713 at
715, 718.

In this case may we recall to the memory of the court that between April 5, 1943 and date of the

correcting amendment in May, 1944, there was no order or interpretation in existence about legal price (Appellant's Brief 47).

The Regulation of April 5, 1943, fixing price under Order No. 3 contains no saving clause that all outstanding regulations and interpretations thereof were to be deemed continuingly valid, nor is there any intimation warranting such an implied limitation. There must be the Administrator's determination of its need (Appellant's Brief pp. 44-56).

As the Supreme Court states "This is too substantial a qualification to be made by judicial interpolation."

"* * * The legislation was too specifically directed against prior unauthorized regulation promulgated no doubt with the best of motives in the great effort against inflation, for us to give it a meaning other than that which the language in the context of its history yields. * * * But the accommodation of the various interests involved in a system of price control are for Congress and not for us, and we must construe its legislation as fairly as we can to catch the will behind the words" (54-55).

Thomas Paper Stock Company v. Porter,
328 U.S. 50 at 54-55.

It will be noted that in the above case the Supreme Court stated that between the effective date of July 16, 1943, and the date of September 11, 1943, where the Administrator made his amendatory order, there was no maximum price upon sales of waste paper and that the price theretofore promulgated prior to July

16, 1943, could not be deemed as “continuingly valid, nor is there any intimation warranting such an implied limitation” (54) (45). It should be noted, furthermore, that the Supreme Court in that case stated that the regulation established “dollars and cents ceiling prices” for the sales of paper (57).

May we again reiterate that in our case the alleged unregistered interpretation was given upon a different worded sentence and that the so-called interpreted sentence was not repeated in the amendment to the regulation was made that “the price paid for the of merchandise was made by appellant.

It was not until Amendment No. 12 to Regulation No. 194, *adopted April 11, 1944*—nine months after the consummation of the sales in this case—that any regulation was made that “the price paid for the commodity is no higher than the supplier’s ceiling” (Reg. No. 194, Amendment 12, Sec. 1418.63(a) (4) amended) (Shyman Ex. S. 1).

The Supreme Court has ruled that

“At any time after the issuance of any regulation or order * * * *or in the case of a price schedule at any time after the effective date thereof* * * * any person subject to any provision of such regulation, order, *or price schedule*, may, * * * file a protest by the (1944) Amendment of Sec. 203 (a) (Stabilization Extension Act of 1944 Sec. 106, 50 U.S.C.A. Appendix Sec. 923 a(2)). The Supreme Court of the United States has held that such protest proceeding may be filed against any provision of a price schedule issued by the Price Administration at any time after the *effective date of the schedule*, notwithstanding the

right or protest had expired through non-user under the act of 1942.”

Utah Junk Co. v. Porter, 328 U.S. 39 at 44 (2).

In that case Mr. Justice Frankfurter states (P. 44 (3).):

“All construction is the ascertainment of meaning, and literalness may strangle meaning. But in construing a definite procedural provision we do well to stick close to the text and not import argumentative qualifications from broad, *unexpressed* claims of policy. * * * Congress liberalized the right to challenge the validity of price regulations so extensively as it did, even reviving rights theretofore lapsed, because it felt, as we have seen, *that rights were unfairly lost through unfamiliarity with the technical requirements of emergency legislation. Price fixing is not static, it is a continuing process.* The considerations of fairness that led Congress to give relief are the same whether a regulation was revised or remained unchanged. There is not a hint that Congress intended to draw a line so artificial as the one the Administrator would have to draw.”

Utah Junk Co. v. Porter, 328 U.S. 39 at 44 (3).

It would seem to Appellant that this court has acquiesced in his argument that the “export” regulations deal with commerce to foreign countries—hereinbefore argued—in its statement that the declared purpose of the O.P.A. Act was “to prevent excessive diversion of American goods to foreign markets * * *”

(Decision, page 4). Alaska is not a “foreign” market but is a territorial dependency of the United States governed by laws specifically made applicable thereto by the United States Congress and the agencies thereof. In the case of the O.P.A. it is admitted that price control in Alaska was governed by M.P.R. No. 194—instead of M.P.R. 193 under which Appellant was charged with violation in this case—and it is admitted by Appellee that there was no ceiling price for the sale of whiskey in Alaska until 1944, months after the sales had been made by Appellant (Appellant’s Brief, pp. 19, 24-25).

As to the decision of this court that only the Emergency Court can pass upon the applicability of the regulation that “established business practices” cannot be disturbed by an unwritten interpretation of the law by the O.P.A. officials, under the *Yakus* case, it would seem that both the Supreme Court and other coordinate courts have decreed that Appellant’s course was correct, as set forth in his brief herein.

Appellant’s violation, if any, according to this court, was in its purchase by an over-ceiling “domestic” price of the commodity from K & L Distributors at Seattle. Appellant still feels that this court, in the use of its chancellory powers, could have offset the overcharge herein when it has held that K & L Distributors have paid in full the amount of such overcharge.

III. This court has dismissed as “without merit” Appellant’s contentions that the Fifth, Fourteenth and Twenty-First Amendments of the United States

Constitution are applicable as a relief to Appellant in this case. May we elaborate somewhat upon such contentions by quoting additional decisions made since the date of the trial of this case. The Commerce clause of the Constitution was exhaustively briefed (Appellant's Brief, pp. 21, 22, 50) and, consequently, it is unnecessary herein to reiterate what was then said.

Hereinbefore, we have pointed out that we not only requested from the authorized officials of the O.P.A. a written statement of the price structure applicable to Appellant's sales and we have urged that "the failure of any written interpretation has deprived Appellant of a valuable constitutional right of attacking the validity of the actions of the O.P.A. officials in this case" (Appellant's Brief, pp. 80, 81). Manifestly, it is impossible to file a protest and appeal therefrom to the U. S. Emergency Court of Appeals, on a mere *oral* interpretation. Such protest procedure is based upon some regulation or order of an authorized official. If all such authorized officials refuse to answer requests for interpretations—as did the officials in this case, as hereinbefore demonstrated—then Appellant is precluded from obtaining relief from the Emergency Court of Appeals. Being so precluded, Appellant's *only* redress is in this court.

This court in its Opinion has relied upon the *Yakus* case as establishing that the "validity of the regulation must be determined by the Emergency Court of Appeals."

But the *Yakus* case states "as we have pointed out such a requirement is objectionable only if by stat-

utary command *or in operation* it will deny, to those charged with violations, an adequate opportunity to be heard on the question of validity. And, as we have seen, petitioners fail to show that such is the necessary effect of the present statute, or that if *so applied as to deprive them of an adequate opportunity to establish the invalidity of a regulation* there would not be an adequate means of securing appropriate judicial relief in the course either of the statutory proceeding or of the criminal trial (446, (38))” * * *.

“Nor do we consider whether one who is forced to trial and convicted of violation of a regulation, while *diligently seeking determination* of its validity by the statutory procedure may thus be deprived of the defense that the regulation is invalid. There is no contention that the present regulation is void on its face, petitioners have taken no step to challenge its validity by the procedure which was open to them, *and it does not appear that they have been deprived of the opportunity to do so. Even though the statute should be deemed to require it, any ruling at the criminal trial which would preclude the accused from showing that he had had no opportunity to establish the invalidity of the regulation by resort to the statutory PROCEDURE, WOULD BE REVIEWABLE ON APPEAL ON CONSTITUTIONAL GROUNDS.*”

Yakus v. United States, 321 U.S. 414 at 446-447 (38).

Again, may we emphasize to this court that the District Court iterated and reiterated that “I have never seen proof in any case of more good faith on the part

of the citizens to try to comply with the O.P.A. statutes and regulations" (Appellant's Brief, Appendix, pp. 4-5). Under such circumstances, the following language of the Emergency Court of Appeals would seem to be worthy of consideration by this court.

"Two succeeding paragraphs of the same section of the statute are pertinent. (9) Paragraph (d) (Sec. 205, Act of 1942) says that no person shall be liable for damages for anything done "in good faith pursuant to x x x any regulation, x x x notwithstanding that subsequently such x x x regulation x x x may be modified, rescinded, or determined to be invalid. Paragraph (e) of the same section provides that if a person "violates" a regulation he shall be liable for damages not less 'than the amount of the overcharge, even if the violation was neither willful nor the result of a failure to take practicable precautions against the occurrence of the violation."

"(5, 6) The provision in paragraph (d) that damages shall not lie for an act done *in good faith pursuant to a regulation* even if that regulation be subsequently modified, is striking. One would assume that damages would not lie under those circumstances without any such statutory prohibition. The insertion of the novel precaution serves to emphasize that a modification of a regulation does not carry *retroactively* a liability for damages. That provision makes necessary a sharp distinction between a mere interpretation by the Administrator and a modification by him of a regulation. *Moreover, when the statute refers to an act in good faith pursuant to a regulation, it seems to contemplate the contingency of a doubt as to the meaning of the regulation. If*

the meaning be certain, and an act be pursuant to it, no requirement of good faith would seem to be requisite to non-liability. The requirement that an act "pursuant to" a regulation be in good faith has significance only if the meaning of the regulation be uncertain. Thus it appears that if one acted according to what was in all good faith the apparent meaning of the regulation, damages will not lie. *The emphasis here must be on the good faith.* The statute does not permit the conjuring up of a possible meaning as a protection. Full effect must be given the stringent requirements of paragraph (e) relating to violations, *but equally full effect must be given to paragraph (d).*"

"*The District Court found as a fact that Mrs. Van Der Loo acted in good faith. No dispute is offered to that finding.* The Administrator says that his ruling of April 25, 1945, was an interpretation of the regulation; that it was a proper interpretation, and that, therefore, any deviation from it was, from the beginning, a violation."

"Section 2 of the regulation was headed "How to find your ceiling prices under this regulation." It plainly directed retailers to compute their ceiling prices by applying "markups."

"If the wholesaler's price be not violative of the requirements of price control, no reason would dictate that the retailer take a loss on that price. Any concept of price control would necessarily contemplate that prices at one level would follow through in normal course in ascending grades to the consumer. This is simple sense. So that a student of these regulations observing the failure

to mention sales prices below cost in the base period, would readily and reasonably conclude that the Administrator meant that ceilings in cost price lines where sales below cost had predominated in the base period should be fixed by the rule applicable where no sales of that line had occurred in that period. In the language of the regulation, he could reasonably conclude that the Administrator meant that such ceilings were to be fixed by Rule 2. It was reasonable that sales below cost be treated as no sales."

"Furthermore, the Administrator himself later amended the regulation to cure this conceded anomaly. And when he did so, he announced that a nationwide survey showed that the number of these abnormally low markup relationships was sufficiently small to preclude any possibility of a general price rise resulting from the action taken in the amendment. He pointed out that these retailers had been unable to purchase merchandise because of the clearance sale retail price they would have to use. In the amendment he promulgated a rule not only for the relief from base-period sales below cost but for all base-period markups more than 20 percentage points below the average for the category. This was his view of what had to be done, and what was reasonable to do, as he looked at the results of his interpretation of the revised regulation."

"The Administrator's position in the case at bar is the barest technicality."

(8) The Administrator's ruling here involved was in the form of a letter written in this particular case by a local enforcement officer. Technically it automatically became an official act

of the Administrator by operation of a general proedural rule of his office. But it was not a published ruling, nor, so far as the record shows, was it public. It was not an administrative interpretation of long standing *but was made after this controversy had arisen*; was written two years after MPR 330 was issued, and was thereafter nullified by Amendment No. 5. Thus, it does not carry the great weight of presumptive validity which *attaches to long-continued, consistent, published administrative rulings.*"

"The Administrator says that his letter to Mrs. Van Der Loo was an interpretation. But if, in fact, it was a change in meaning, it was a modification. He had power either to interpret or to amend. But if the Administrator really changed the meaning of the regulation, he could not thereby render liable to damages a retailer who in good faith had theretofore pursued the original regulation."

"(9, 10) *The District Court gave appellee the benefit of her clear good faith* and so, in effect, held that she was not "violating" the regulation; and that in following what was both its letter and its sense, she was acting pursuant to it within the meaning of the two pertinent paragraphs of the statute. We agree with that view. The ordinary meaning of "markup" does not include a sale below cost, and that ordinary meaning is consistent with the purpose of the Act and with the later thought of the Administrator. We think it was the meaning of the regulation and that the "interpretation" was really a change in meaning."

"The question is not whether the ruling of the

Administrator was valid prospectively as an administrative regulation. The question is whether it was so clear a translation of the terms of the original regulation as to render retroactively the prices of this retailer a violation of that regulation.”

Thus, Mrs. Van Der Loo seems to have had no judicial decision upon her contention as to the proper interpretation of the regulation.

Fleming vs. Van Der Loo, 160 F.(2nd) 906,
at 911, 912, 913.

On August 15, 1947, the U.S. District Court of Appeals, 7th Circuit, in a case where the undoubted good faith of the defendant was proven, decided:

“We are not unmindful of the important rule performed by plaintiff during and following the recent war and of the almost superhuman difficulties with which it was confronted. Neither are we unmindful of the difficulties confronting a person in business who honestly and in good faith attempted to comply with the innumerable price lists and regulations which were promulgated by the plaintiff. It is a matter of common knowledge that an individual merchant with two or three employees under his personal supervision was unable, however good his intentions, to achieve complete compliance in the matter of prices. Often he was confused and bewildered in an effort to interpret the regulations, much less obtain compliance. As the magnitude of a business increased, with its personal supervision further removed, we apprehend that the difficulties were correspondingly enhanced. Certainly

100% compliance could not be expected in any event; in fact, it would be impossible." The Court dismissed the case.

U.S. ex rel Paul A. Porter, Adm. vs. Kroger Grocery and Baking Company. (Decision rendered Aug. 15, 1947; not yet in Federal Advance Sheets.)

It is appellee's contention, now upheld by the opinion of this Court, that Kessler & Levine, doing business as K & L Distributors, *sold and delivered* the liquor in this case, to Alfred Shyman, doing business as Alaska Distributors Company, in the City of Seattle, State of Washington; that such sale *and delivery* constituted a *domestic* sale in said State of Washington, and that thereby a Seattle "*domestic*" price was the established price upon which Appellant Shyman must base his figures for sale to his customers in Alaska; and that by such circumstances Appellant Shyman became an "exporter" from Seattle to the Alaska business locations of his customers.

Under the basic law of the State of Washington it is provided in Section 23-J, (Shyman's Exhibit S. 22) Pamphlet of the Washington State Liquor Act, "A liquor importer's license may be issued to any qualified person, firm or corporation, entitling the holder thereof to import into the State any liquor other than beer; * * * " to store the same within the state; *and to sell and export the same from the state;*
* * * "

In accordance therewith K & L Distributors had the right under their Importer's License to import

such liquor. But K & L Distributors' duty under the law was to "*sell and export the same from the State.*" (Appellant's Opening Brief, pp. 20-22; Appellant's Reply Brief, pp. 2-4.) There could be no break in the "current of commerce by the ORAL declaration of an O.P.A. official that the liquors had come to rest in Seattle whereby a "domestic" price would be applicable thereto.

Under the 21st Amendment to the United States Constitution the State of Washington had the undoubted right to insist that no liquors could be sold within the State except under such conditions as it prescribed. The sole control of the liquor while within the confines of the State was entirely within the powers of the Washington State Liquor Control Board, and such liquors were always subject to the rules and regulations of such Board. Under such regulations the Washington State Liquor Control Board had provided (Section 89, Shyman's Exhibits No. 22, p. 93) that such liquor must be stored in a storage warehouse under the Board's control and that "no liquor shall be removed from any storage warehouse except for sale or delivery to the Board *or for export from the State.*" (Section 97, Shyman's Exhibit No. S 22, Page 94)

Under the law of the State of Washington, therefore, Appellee's ORAL interpretation that there was a "domestic sale at Seattle" and that K & L Distributors sale was not an export sale should not be upheld by this Court.

It may be that if the O.P.A. officials had estab-

lished a price at Seattle of the Tom Burns Whiskey in this case by any *written order or written interpretation*, there might have been presented the question as to whether the O.P.A. under its war time powers had the precedent right to establish prices in the State of Washington without the acquiescence of the Washington State Liquor Control Board. But, assuredly under the facts of this case wherein such *local* sale in Seattle was being asserted only by oral interpretation of O.P.A. officials, the undoubted right of the State to insist *that there can be no sale except for export purposes*, should be upheld by this and other courts.

As was said hereinbefore, it was not one of the purposes of the O.P.A. Act of 1942 to permit the Administrator to say *orally* that Appellant's purchase was a "domestic" sale. The Administrator's *only* power was to fix prices.

Collins v. Fleming, 159 F.(2d) 431, at 437, 438, 439.

The Supreme Court of the United States in its decisions in recent years has invariably upheld the right of the State to control the sale of liquor within its borders under the 21st Amendment to the Constitution of the United States.

Mr. Justice Brandies states that the 21st Amendment confers "upon the state the power to forbid all importations which do not comply with the conditions which it prescribes." (62 * * * A classification recognized by the 21st Amendment cannot be deemed forbidden by the 14th Amendment (equal protection

clause) (64) * * * To say that, would involve not a construction of the (21st) Amendment, but a re-writing of it. (62) * * *

State Board of Equalization v. Youngs Market Inc., 299 U.S. 59, at 62, 63, 64.

Mahoney v. Joseph Triner Corporation, 304 U.S. 401, at 403, 404.

“The substantive power of the State to prevent the sale of intoxicating liquor is undoubted * * * Since the 21st Amendment, as held in the *Young* case, the right to prohibit or regulate the importation of intoxicating liquor is not limited by the Commerce clause and * * * discrimination between domestic and imported intoxicating liquors, is not prohibited by the equal protection clause. (394.)”

Indianapolis Brewing Company v. Liquor Control Commission, 305 U.S. 391 at 394.

Joseph S. Finch & Company v. McKittrick, 305 U.S. 395, at 397, 398.

(Justice Reed) :

“The State of Virginia ‘could conclude * * * that she could not safely permit the transportation of liquors through her territory by those who concedely mean to break Federal Laws (138)’ * * *

(Justice Black) :

“The 21st Amendment has placed liquor in a category different from that of other articles of commerce * * * this much is settled; local, not national, regulation of the liquor traffic is now the general Constitutional policy (138) * * *

Virginia seems to think that, unless adequate protectionary regulations are devised and enforced, liquor shipments ostensibly being transported through her territory to a neighboring state could be diverted to bootleg purposes contrary to her laws. (139) * * *

(Justice Frankfurter):

“The 21st Amendment prohibits the ‘transportation or importation into any State * * * of intoxicating liquors in violation of the laws thereof’, not when the liquor is for delivery and use but ‘for delivery or use therein.’ In other words, liquor need not be intended for consumption in a State to be deemed to be imported into the State and therefore subject to control by that State. (141) * * * Since Virginia has power to prohibit the importation of liquor within that Commonwealth, it may effectuate that purpose by measures deemed by it necessary to prevent evasion of its policy by pretended through shipments. In a word, having the power to prohibit liquor from coming into a State, a State may take measures against frustration of that power. (142) * * *

Carter v. Commonwealth of Virginia, 321 U.S. 131 at 137-138.

Justice Frankfurter has stated:

“Price fixing is a restraint upon trade.” * * *
 “The 21st Amendment subordinated the Commerce Clause to the power of the state to control, and to control effectively the traffic of liquor within its borders (300) * * * as a matter of constitutional law, the result of the 21st Amendment is that a State may erect any barrier it pleases to the entry of intoxicating liquors (300)

* * * If a state for its own sufficient reasons deems it a desirable policy to standardize the price of liquor within its borders either by a direct price fixing statute or by permissive sanction of such price fixing in order to discourage the temptation of cheap liquor due to cutthroat competition, the 21st Amendment gives it that power and the Commerce clause does not gainsay it." (301) * * *

U. S. v. Frankfort Distilleries, 324 U.S. 293, at 301.

Justice Jackson recites:

"These clauses of the 21st Amendment create an important distinction between state power over the liquor traffic and state power over commerce in general. The people of the United States knew that liquor is a lawlessness unto itself. They determined that it should be governed by a specific and particular constitutional provision. * * * It was their unsatisfactory experience * * * that resulted in giving an exclusive place in constitutional law as a commodity whose transportation is governed by a special constitutional provision. (398, 399) * * * So the 21st Amendment made the laws as to delivery and use in the State of destination the test of legality of interstate movement. This obviously gives to state law a much greater control over interstate liquor traffic than over commerce in any other commodity.

"If the 21st Amendment is not to be resorted to for the decision of liquor cases, it is on the way to becoming another 'almost forgotten' clause of the Constitution." (390) * * *

Duckworth v. State of Arkansas, 314 U.S. 390, at 398, 399.

“There can be no delivery to one not authorized to receive liquor.”

Ziffirin Inc. v. Reeves, 308 U.S. 132 at 140 (12).

This court has said:

“The decisions of the Supreme Court since the adoption of the 21st Amendment recognize the practically unlimited power of the states to regulate or prohibit the transportation of alcoholic beverages, irrespective either of the commerce clause or the equal protection clause of the Constitution. (966) * * * Interstate Commerce in liquor, *not in violation of state laws*, was left matter of national concern. (967) * * * The broad theory of the Sherman Act—that trade should be free of artificial restraints—is in many respects incompatible with the policy of state liquor control legislation; and wherever such conflict exists the Sherman Act must give way, just as the Commerce Clause itself gives way in identical circumstances. Where invocation of that Act tends to hamper or interfere with the enforcement of State Laws regulatory of the transportation or importation of intoxicants, the Act is *unenforceable*. By the terms of its own fundamental law the national government has disabled itself from prosecuting as an offense that which a state has commanded or implicitly encouraged as a means of controlling the traffic of intoxicants within its borders,” (963, (3)) *Washington Brewers Institute v. United States*, 137 F.(2d) 964 at 966, 967, 968.

Again, it should be reiterated, that the O.P.A. under its war powers may place a maximum price upon

“legal” or “illegal” whiskey. But we are contending herein that when the State of Washington has declared that a “domestic” sale of whiskey cannot be made within its boundaries no unauthorized official of the O.P.A. by an oral interpretation and without any written order or regulation, and with no written price fixing, may declare that such transaction is a *sale in the state*—whether legal or illegal.

Other decisions of the Supreme Court seem applicable to the facts of this case.

The war power of the United States, like its other powers, is subject to applicable constitutional limitations.

Hamilton v. Kentucky Distilleries & Warehouse Company, 251 U.S. 146 at 155. (Mr. Justice Brandies)

A defendant in an enforcement proceeding has a right to challenge, on constitutional grounds, whether or not a procedure has been “properly interpreted.”

Case v. Bowles, 327 U.S. 92, at 98 (7).

“Where the method pursued by the Department is fundamentally erroneous it constitutes a denial of due process of law and the courts do not have to uphold the interpretations of department officials.”

N. P. Ry. v. Dept. of Pub. Wks., 268 U.S. (80 L. ed.) 836 at 839 (Wash.).

C. M. & St. P. Ry. v. Pub. Util. Cm., 274 U.S. (71 L. ed.) 1085 at 1090.

“The idea which is now sought to be read into

the grant by Congress to the Administrator * * * is not so complicated nor is English speech so poor that words were not easily available to express the idea or at least to suggest it. After all, legislation * * * is addressed to the common run of men and is therefore to be understood according to the source of the thing, as the ordinary man has a right to rely on ordinary words addressed to him."

Addison v. Holly Frost Products, 322 U.S. 607 at 618 (6).

For the reasons hereinabove detailed and set forth, the Petition for Rehearing should be granted.

Respectfully submitted,

Daniel B. Trefethen

DANIEL B. TREFETHEN,

Attorney for Appellant.

CERTIFICATE OF COUNSEL PURSUANT TO
COURT RULE 24

STATE OF WASHINGTON
COUNTY OF KING

SS.

DANIEL B. TREFETHEN, being first duly sworn, on
oath certifies and says:

That he is the attorney for Appellant in this cause;
that he is an attorney admitted to practice before the
District Court of the United States for the Western
District of Washington, Northern Division, and before
this Court; that he makes this certificate in compliance
with Rule 24 of the rules of this Court; that in his
judgment the petition for rehearing and the additional
and supplemental authorities presented herein, are
well founded; and that the same are not interposed
for delay.

Daniel B. Trefethen

Subscribed and sworn to before me at Seattle, Wash-
ington, this 29th day of September, 1947.

Geo. P. Sanders

*Notary Public in and for the State of
Washington, residing at Seattle.*

No. 11,425

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

WESTERN NATIONAL INSURANCE COMPANY
(a corporation),

Appellant,

vs.

CHARLES A. LECLARE, JR.,

Appellee.

Upon Appeal from the District Court of the United States
for the District of Nevada.

APPELLANT'S PETITION FOR A REHEARING.

ROYAL A. STEWART,
131 West Second Street, Reno, Nevada,

MORLEY GRISWOLD,

GEORGE L. VARGAS,
Reno National Bank Building, Reno, Nevada,

*Counsel for Appellant
and Petitioner.*

FILED

SEP 14 1947

PAUL P. O'BRIEN,

CLERK

IN THE

**United States Circuit Court of Appeals
For the Ninth Circuit**

WESTERN NATIONAL INSURANCE COMPANY

(a corporation),

Appellant,

VS.

CHARLES A. LECLARE, JR.,

Appellee.

**Upon Appeal from the District Court of the United States
for the District of Nevada.**

APPELLANT'S PETITION FOR A REHEARING.

*To the Honorable Francis A. Garrecht, Presiding
Judge, and to the Honorable Associate Judges of
the United States Circuit Court of Appeals for
the Ninth Circuit:*

Comes now the Western National Insurance Company, the Appellant in the above entitled cause, and presents this, its petition for a rehearing of the above-entitled cause, and in support thereof respectfully shows:

I.

Your petitioner is aggrieved by the ruling of this Honorable Court in refusing an extension of time

within which to file its reply brief in this cause. Although it is well known to Appellant that it is within the sound discretion of this Court to refuse or allow the filing of briefs after the expiration of the time fixed by the rules of this Court; nevertheless, this Court did, on the 20th day of June, 1947, the day set for oral argument of this case, grant leave to Appellee to have printed and file his brief on or before the 25th day of June, 1947, and subsequently, on the 24th day of June, 1947, granted a further extension of time to the 2nd day of July, 1947. Under these extensions, Appellee was granted leave by this Court to file his printed brief after oral arguments were presented, and more than sixty days after the date it should have been filed in order to comply with the rules of this Court.

II.

The brief filed by Appellee contains a theory of law pertaining to contracts to renew and renewals of existing insurance, which is entirely different and distinguishable from the law applicable to the issues raised by the pleadings in this case, and although the Appellee endeavored to inject such theory of law into this case after the evidence had been closed, by moving the Trial Court for leave to amend his Complaint, the Court in sustaining the objection of counsel for Appellant and denying the motion said:

“* * * it seems to me that Mr. Vargas’ (counsel for Appellant) objection is good. He has a theory of law here. With that amendment, the basis of that theory, which has already been presented to

the jury, would be removed and for that reason the application to amend will be denied.” (Transcript p. 165.)

III.

The cause of action stated in the Complaint filed by Appellee is based upon an alleged oral contract of insurance covering a building described therein, for the amount of Five Thousand (\$5,000.00) Dollars, and the improvements on said property, for the amount of Seven Hundred (\$700.00) Dollars. The complaint contains no allegation whatsoever of a renewal or an oral contract for the renewal of the old policies in the amount of Two Thousand (\$2,000.00) Dollars and Three Thousand (\$3,000.00) Dollars which had expired. (Transcript pp. 5-6.) On the contrary, it is specifically alleged in the Complaint that the cause of action is based on an oral contract for insurance, and by the allegations contained therein the beneficiaries are different and the amounts are in excess of the insured values as set forth in the old expired policies. Now, in this Court, and for the first time, Appellee in his brief, departs from the issues raised by the pleadings and the law applicable thereto, and expounds on the theories of the law as applicable to parol contracts to renew and renewals of existing insurance contracts.

IV.

The theories of law applicable to the issues involved herein are set forth in the instructions which were given in the trial Court, and no mention whatever is

contained therein, either as to a question of fact or a question of law regarding oral contracts of renewal or oral contracts to renew. (Transcript pp. 26-36.)

V.

The extension of time requested by Appellant for filing its reply brief became necessary as a result of Appellee's apparent abandonment of the theories of law applicable to the issues joined in this case, and in the instructions given by the Court below, and then proceeding in this Court, for the first time, on the theory of law applicable to parol contracts to renew and renewals of existing insurance policies.

VI.

In view of the written argument of Appellee on the law applicable to renewals and contracts to renew existing insurance contracts, your petitioner feels that this Honorable Court may have overlooked the fact that such law is not applicable to the issues raised by the pleadings filed in the Court below, and the instructions given by the Trial Court, upon which the verdict of the jury was rendered.

VII.

That due to the delay of Appellee in the filing of his brief, your petitioner did not have an opportunity to study it prior to the hearing in this Court, and was, therefore, deprived of an opportunity to present an oral argument on the points raised therein, the authorities cited, and in particular the theory of law

pertaining to renewals, advanced therein for the first time in this case, which theory of law Appellant contends is not applicable to the issues involved in this case.

VIII.

The evidence is insufficient to support a verdict in favor of Appellee on the issues joined in this case. The cause of action stated in the Complaint filed by Appellee is based upon a new and original oral contract of insurance, and issue was joined thereon. The evidence adduced in proof of the alleged new and original oral contract of insurance, when standing alone, and considered apart from the facts relative to the old insurance contracts which had expired, is wholly insufficient as a matter of law to establish an oral contract of insurance, according to the overwhelming weight of authority.

Wherefore, upon the foregoing grounds, it is respectfully urged that this petition for a rehearing be granted, that your petitioner be permitted to file its reply brief, and that leave be granted for re-argument.

Dated, Reno, Nevada,
September 10, 1947.

WESTERN NATIONAL INSURANCE COMPANY,
By ROYAL A. STEWART,
MORLEY GRISWOLD,
GEORGE L. VARGAS,

*Counsel for Appellant
and Petitioner.*

CERTIFICATE OF COUNSEL.

Morley Griswold, George L. Vargas and Royal Stewart, counsel for the above-named Western National Insurance Company, do hereby certify that the foregoing petition for a rehearing of this cause is, in our judgment, well founded and that it is not interposed for delay.

Dated, Reno, Nevada,
September 10, 1947.

ROYAL A. STEWART,
MORLEY GRISWOLD,
GEORGE L. VARGAS,

*Counsel for Appellant
and Petitioner.*



